MANITOBA LAW REFORM COMMISSION

TRUSTEE INVESTMENTS:

THE MODERN PORTFOLIO THEORY

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CHAPTER 1

INTRODUCTION

In the fall of 1997, the Commission retained the services of Dr. Donovan W.M. Waters, Q.C., an internationally renowned author and educator, to prepare a paper on the issue of the Modern Portfolio Theory (Prudent Investor Rule). Upon the paper being completed in May 1998, it was circulated to a select group of interested individuals and organizations in order to solicit their views. A list of the persons and organizations who received copies of the paper as well as those who responded is contained in Appendix C to this Report.

The Commission wishes to thank Dr. Waters for his assistance in preparing the draft paper and this final Report. His knowledge and expertise in the field have been invaluable in completing this project. We also wish to thank all those who responded to the draft paper whose comments have assisted us in reaching our final conclusions.

A. THE ISSUE

It is one of the axioms of the law of trusts that the purpose of investment when the power is conferred upon trustees is to enable them to achieve the objects of the trust.

In all employee benefit trusts a power of investment will be given to the trustees that is compatible with their needs in achieving the pension or health and welfare provisions of such trusts for a revolving class of employee beneficiaries. This power is also regulated by statute. Indeed, in all investment trusts, such as public unit trusts in the United Kingdom and 'mutual fund' trusts in North America, the investment power of the trustees is carefully and explicitly delineated. By contrast asset holding trusts, which include the holding of security at the call in stated circumstances of the lender, do not involve investment, and accordingly such a power is most unlikely to be given to the trustees. And royalty trusts, like other trusts of income-producing assets held for a class of investors, are essentially designed for immediate distribution.

Family provision trusts on the other hand - traditionally being the only ones (except for charitable trusts) prior to the mid-19th century) - are very likely to contain an express power of investment, because the assets are usually intended as a fund which will provide for a beneficiary or the beneficiaries over a period of time. In these cases, such a power will have the scope with which the family member creating the trust feels comfortable as well as conform, so far as the trust creator permits, to investment requirements for the purpose of attaining the trust objects. But the times are changing. Many lawyer-advised trusts -

certainly not all - will today give the trustees a scope of investment asset selection that they (the trustees) would have if they were the absolute owners of the trust assets.[1]

But what if, given the trust objects, the assets implicitly require investment and the trust creator is silent as to the power of investment? That cannot mean that the trustees may keep the trust fund indefinitely in a bank account. Nor does it mean, on the other hand, that the trustees may invest in whatever is pleasing to them. They can do neither because they are fiduciaries, charged with exercising care and attention in discharging all trust business, as they discharge their discretionary dispositive obligations, for the benefit of another or others.

Like that of all the Canadian common law provinces and of the territories, *The Trustee Act* of Manitoba[2] sets out a minimal investment practice that the trustee or trustees[3] are to follow if the trust instrument, if any, whether a will, deed or other document or documents, says nothing expressly or impliedly as to the power of investment intended by the person or persons creating the trust. The present rule in Manitoba is that trustees may invest or re-invest in any security or tangible property provided that each such security or asset retained or selected by the trustees would be regarded as prudent by the standard of a reasonable person accustomed to business[4] who is investing not for himself or herself but for the benefit of others. In the event of a dispute as to whether trustees were prudent when a past loss was experienced, return (i.e., income or capital growth) over a period was low, or an alleged investment opportunity was not seized, the court applies this general standard of prudence.

The issue to be considered in this Report is whether, and if so in what manner, Manitoba should adopt the more recent formulation of the rule that is now in practice in more than one-half of the states in the United States of America. Under this rule whether prudence in the investment or re-investment of any security or tangible asset was shown in any particular circumstances is assessed on the basis of an approach known as portfolio investment. That is to say, prudent behaviour is that which a reasonable person of business would follow if he or she were managing a fund or portfolio of investments, when the concern is not for the suitability in itself of each security or asset, but of the investment holdings seen as a whole.

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[1]Exercise of the power must still of course be responsible.

[2]*The Trustee Act*, C.C.S.M. c. T160.

[3]A trust may have one or several. This Report will sometimes speak of a trustee and sometimes of trustees. Nothing turns on the difference.

[4]A 'reasonable person of business' is a commonly used phrase spelling out what level of "sagacity" is required, i.e., that amount of informed skill that would be possessed by the average person who is engaged in business; a trustee must demonstrate "sagacity", as well as "prudence" and "vigilance": *Fales* v. *Canada Permanent Trust Co.*, [1977] 2 S.C.R. 302 at 318; 70 DLR (3d) 257 at 270.

B. OUTLINE OF REPORT

In Chapter 2, the Commission will provide a brief overview of the historical background of trustee investment legislation in Manitoba and review developments in other jurisdictions. Chapter 3 will review the recently adopted Uniform Law Conference of Canada's *Uniform Trustee Investment Act, 1997* and make recommendations on whether it should be adopted in whole or in part in Manitoba. Chapter 4 contains further recommendations on provisions other than those contained in the Uniform Act which should be considered for implementation in Manitoba. Chapter 5 is a list of the Commission's recommendations. The proposed draft legislation is contained in Appendix A; followed, in Appendix B, with excerpts of the current provisions of *The Trustee Act* of Manitoba which are relevant to the issues dealt with in this Report. Appendix C is a list of the persons and organizations to whom copies of our draft paper was circulated and of those who responded.

C. ACKNOWLEDGMENTS

In addition to Dr. Waters, the Commission wishes to thank the persons and organizations who took the time to respond to our draft paper. Although few in number, their comments and criticisms have greatly assisted us in reaching our final recommendations. We also wish to thank the Manitoba Law Foundation for providing us with some of the additional funds necessary to complete this project.

CHAPTER 2

HISTORICAL BACKGROUND AND DEVELOPMENTS IN OTHER JURISDICTIONS

A. THE STATUTORY HISTORY OF TRUSTEE INVESTMENTS IN MANITOBA

In Manitoba, as elsewhere in Canada, the original statutory provision which endured for many years was a listing of investments, mostly federal and provincial government bond issues with the later addition of very low risk 'blue chip' stock.[1]

In the absence of a contrary provision in the trust instrument, trustees were authorized to select among those investments only. These were known as 'legal list' investments; they were specific securities which the legislature considered 'safe' for trustee investment. In the second half of the 1960s it became apparent with the volatility of currency values and a significant annual inflation rate that there was no automatic safety in fixed interest securities. Also, rather than suggest that this pre-1914 policy was still sound, it might well be preferable to allow trustees to invest in any fixed interest or growth stock on the publicly quoted markets, provided only each asset selection was prudent. As in the *Restatement (Second) of Trusts* in the United States, certain criteria were listed which a trustee exhibiting prudence would consider before making that selection.

Though four provinces have retained the statutory legal list to this day, Manitoba introduced the so-called 'prudent man' (now the 'prudent person') rule in October, 1983, repealing the then legal list and enacting new sections 70-77 and 79.1. Those sections (renumbered) remain in the present Act.[2]

Subsection 68(2) of the present Act provides that:

> . . . in investing money for the benefit of another person, a trustee shall exercise the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

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[1] *The Trustee Act*, R.S.M. 1970, c. T160, s. 70(2).

[2] *An Act to Amend The Trustee Act*, R.S.M. 1982-83-84, c. 38, ss. 5 and 6. The present sections (ss. 68-75 and 79) are reproduced in Appendix B to this Report. These amendments implemented recommendations made in an earlier Commission report on trustee investment: Manitoba Law Reform Commission, *Investment Provisions under "The Trustee Act"* (Report #50, 1982).

The Act contemplates prudence in the retention or selection of each individual investment, but it contains no criteria of the sort that the prudent person would consider on each such occasion. In recommending the 'prudent person' rule, this Commission had intended that the criteria existing in the *Uniform Trustee Amendment Act, 1970,* would be issued in the form of regulations under *The Trustee Act*. Alternatively, in order to assist and guide trustees, it was intended that they be contained in a Trustee's Handbook which would be made available to the general public.[3] However, neither the issue of regulations nor the release of a Handbook took place.

The Commission was of the view in 1982 that placed in the Act itself these criteria could be interpreted by the courts as being a mandatory checklist, prudence being held to be absent if one of the criteria were not met. This had been one of the problems with the 'legal list'. Trustees and, if the trustees were challenged by beneficiaries, the courts looked to see whether the proposed or challenged investment was on the list. If it was there, the requirement of prudence was held to be satisfied, however questionable may have been the original acquisitioon or the length of time of an investment's retention. The acquisition may have been unfortunate timing given the state of the market, and retention unwise if a decline in the purchasing power of the currency was under way.

The remaining sections introduced in 1983 are not of immediate interest in the present context, except for section 79.1 (now section 79) which introduced a novel provision that remains unique among the Canadian jurisdictions that have adopted the prudent person rule. It describes what forward planning the person who is prudent would take. That person would create a plan (a "general policy") of investment for the trust. The section concerns trustee liability for loss on the basis of whether, prior to the loss, such a plan for the entire trust fund existed, met the Act's definition of prudence, and was being followed in the case of the "particular investment" that is later impugned.

This section introduced into the law of Manitoba the principle of portfolio investment. That is, the prudent trustee does not take an amount of trust capital or income and look at investment possibilities in general, seeking something for that particular sum of trust money that is 'sound' among available stocks, bonds and other interest-bearing securities, mortgages and rental-bearing real estate. Such a trustee develops a policy for the investment of the entire fund before making an investment in anything. In this way the trustee will necessarily examine the purpose, the likely duration of the trust, and the size in value of the total trust fund or assets. The payments of income or capital or both that have to be made will be known or be broadly calculable, and this will lead to a consequent decision as to the likely degree of liquidity required at any future time or at particular times.

However, the current section 79 does not spell out the above consequences of portfolio investment. It merely abrogates the so-called 'anti-netting' rule of case law which prohibits a trustee, charged with breach, from setting off losses on an impugned investment

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[3]Manitoba Law Reform Commission, *supra* n. 2, at 29, recommendation 3.

against gains made on a different investment, even if both investments are those that a prudent *portfolio* investor acting for the benefit of another could have made. The section simply provides a defence to such a trustee.

B. THE MODERN PORTFOLIO THEORY OR 'PRUDENT INVESTOR' RULE

The limitations of the prudent person rule as set out in *The Trustee Act* are that it does not sufficiently reflect the modern approach to investment. While section 79 is a valuable step in the right direction, it is essentially the long unpopular 'anti-netting' rule that is its concern.

The modern portfolio theory or "prudent investor rule" is the response of modern economists to the investment task that any person entering the market today with funds needs to follow.[4] The theory essentially argues that, because of inflation and globalization of investment activities, there is no longer any validity to the investment notions that continued to govern fund managers and investment consultants as well as trustees for some years after the Second World War. In those days, the notion was entertained that the essential task of the trustee was to conserve capital, to acquire the best fixed interest rate that the market provided consonantly with the conservation of capital, and to retain the funds so accumulated until the time came in the lifetime of each trust for the fund to be expended. Usually the income arising would be distributed and finally the capital would be handed over to a beneficiary or various beneficiaries. That notion had been accepted since the 19th century by all those investing funds, and it was the onslaught both of the disappearance of the gold standard in the 1930s and the volatility of currency values after the War, together with inflation, that finally in the 1950s began to bring down the traditional prudent man rule. The prudent man rule was first canvassed in 1830 in the United States and subsequently had a long career, culminating in the *Restatement (Second) of Trusts* in 1959, which gave the prudent man theory the accolade of general acceptance *in lieu* of the legal list. It began probably in the early 1960s to decline markedly as a convincing explanation of what non-fiduciary investors were doing.

However, the strength of the American dollar continued to prevail throughout the 1970s and much of the 1980s so that the significance of the inadequacy of the former legal list and 'prudence' investment theories that had prevailed throughout the United States, the Commonwealth and Europe was not seen other than by the more forward-looking economists. However, gradually awareness grew that market practices and investment styles were changing. It was therefore in the later 1980s that the American Law Institute, as the lead influence on American legal reform, became engaged with inquiries into whether the

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[4]A good deal has been published on this subject, including *The Prudent Investor Rule, Restatement (Third) of Trusts* (1992). See also E.C. Halbach, Jr., "Trust Investment Law in the Third Restatement" (1992) 27 Real Prop., Prob. and Tr. J. 407. Professor Halbach is the Reporter to the *Restatement (Third) of Trusts.* See also J.E. Langbein, "The Uniform Prudent Investor Act and the Future of Trust Investing" (1995-96) 81 Iowa L. Rev. 641.

prudent man or prudent person rule for fiduciaries should now be developed to reflect modern practice.

As already observed in this Report, the modern portfolio theory rejects the notion that prudence is reflected in the selection only of investment assets, and concentrates attention upon the management of the entire portfolio that a trustee has. It emphasizes that there is risk attaching to every asset which a trustee acquires, and that the lowering of risk is associated with balancing the risk elements throughout the entire holding of assets. Where there is high risk there should be compensating low risk and where there is secure investment but low income return there should be a balancing growth investment. Prudence is reflected in the modern theory not so much in the rejection of 'speculative' assets but in the concern to diversify and so to balance the risk between assets. Prudence seeks a steady and satisfactory level of return across the portfolio of investments. The alternative term of 'prudent investor' is used because, whereas the prudent person rule concentrates solely upon the element of prudence, the modern theory assumes that an investor is concerned with prudence in the context of balancing the entire portfolio. As a term, 'prudent investor' refers therefore to investment practice which is portfolio-minded in its acquisitions and dispositions but nevertheless avoids the most high risk asset acquisitions. This latter avoidance takes place because especially high risk assets are investments that bring too much risk for the return they will give. Moreover, they require so much balancing elsewhere in the portfolio. The prudent investor also avoids them because trusteeship is concerned with the risk tolerance of the particular trust that is being administered - its objects and its likely duration. Such a fiduciary will ask - what work has this money to do? Pure speculation has no place in such responsible investing.

Another reason for the legal attention given in the late 1980s in the United States to the modern theory stems from the fact that the prudent person rule in the hands of many courts was becoming as much a straight jacket as had been the legal lists, and such lists in the late 1980s had long been rejected by a majority of the American states. The prudent person rule had become encumbered over time with case law that largely negatived the freedom from fixed list thinking that was intended to replace the approved investments approach. Judicial decisions over the period from the 1930s to the 1980s had tended to attach sub-rules to the prudent person rule and those sub-rules emphasized 'preservation of the fund', 'earning income and retaining capital'. Prudence was associated with the condemnation of 'speculation' in stock selection and the 'safety' of fixed-interest investments.[5]

As a consequence, where the trust instrument did not expressly authorize the trustees to invest on a wider basis than that given by the law of the particular state, fiduciary investing throughout the United States led to portfolios which were little different from that which the modern fixed list would produce. That is to say, federal and state government and 'blue chip' corporate fixed-interest securities, together with top quality 'blue chip' stock,

[5] See, e.g., *Nestle* v. *National Westminster Bank plc*, [1994] 1 All E.R. 118; [1993] 1 W.L.R. 1260 (C.A.).

were the only assets that the courts considered the prudent trustee could properly acquire. Even where the trust instrument gave greater freedom to the trustee, by the late 1980s case law had often limited that freedom with a joining of 'fiduciary principles' and 'prudence', ideas that were derived from the interpretation of prudence in the context of instruments that were silent as to investment powers.

Precisely the same developments have occurred in Canada, and financial institutions in this country, being tied to *Trustee Act* investment, have felt obligated to err on the side of conservatism. This has often meant a high percentage holding of fixed-interest securities, and a proportionately lower percentage of 'blue chip' stock. With a declining dollar value, the effect in recent years and in many instances has been the significant decline of the purchasing power of the trust fund in question over the lifetime of a life tenant, and a consequent concern among capital remaindermen that what in fact the particular trustee financial institution had been doing was paying an 8% to 10% income rate to the life tenant and effectively ignoring the impact the fixed-interest holding was having on purchasing power. It is not without interest that very little of this litigation is reflected in the reports of decided cases. Most often these actions are settled or the plaintiffs ultimately discontinue their actions, being advised that the likelihood is small of the courts holding liable a trustee who has invested within a legal list or who, being governed by prudence, has concentrated upon fixed-interest securities.

It appeared to American legal scholars in the late 1980s that there was a marked disparity between what investors were actually doing in the market and what investment conduct the law permitted to trustees. Only those trustees who were authorized by the instrument in question to invest on a wider basis could take advantage of what was happening in the investment world. It became apparent to these scholars that there was probably a considerable scale of breach of trust in fact occurring, simply because investment consultants, in all innocence and in pursuit of current economic practice, were guiding trustees into policies of investment that were simply unauthorized. It was during May, 1990, that the American Law Institute adopted for the purposes of the *Restatement (Third) of Trusts* the so-called prudent investor rule, and in 1992 the Institute published the new *Restatement* provisions on that rule, thus reversing the position the Institute had taken in 1959 in the *Restatement (Second) of Trusts*. In 1994 the National Conference of Commissioners of Uniform State Law adopted the *Restatement* position,[6] and thereafter states across the Union began to introduce or to consider the adoption of the prudent investor rule.

[6]See further, Halbach, *supra* n. 4.

C. THE *UNIFORM TRUSTEE INVESTMENT ACT, 1997*[7]

It was in 1970 that the Uniform Law Conference of Canada adopted the prudent person rule and, in 1995, the Conference decided to re-examine the subject of trustee investment. It was developments in the United States and, in particular, the *Uniform Prudent Investor Act* adopted by the National Conference of Commissioners on Uniform State Laws in 1994, which triggered this re-examination. The overall purpose in the United States was to integrate the modern portfolio theory into the general standard of prudence. The Conference's British Columbia Commissioners reported in 1996[8] on the prudent investor rule and in particular upon the then very recent American uniform legislation and, in 1997, the Uniform Law Conference of Canada issued the *Uniform Trustee Investment Act, 1997*.

'Legal list' legislation remains in British Columbia, Alberta, Québec and Newfoundland. New Brunswick, the Yukon Territory and the Northwest Territories have each adopted, like Manitoba, the 1970 uniform legislation or the principles of that legislation. To this date, four Canadian jurisdictions have statutorily enacted the prudent investor rule. Nova Scotia introduced 'prudent' investor phraseology of its own[9] before the *Uniform Trustee Investment Act* was released by the Uniform Law Conference in 1997; in that year Prince Edward Island adopted the Uniform Act to the letter,[10] and on June 11, 1998, Saskatchewan also adopted that Act. [11] However, in the Saskatchewan legislation there is one policy change, and there are several changes of implementing language. In 1998, the Ontario government re-introduced a Bill that it had allowed to die on the Legislature's Order Paper the previous year. This amendment to the provincial *Trustee Act* was given Royal Assent on December 18, 1998.[12] It adopts most of the features and the language of the Uniform Act, but has made two policy changes, one of considerable significance. Later in this Report, the changes from the Uniform Act that the provinces of Saskatchewan and Ontario have made will be discussed A committee of the British Columbia Law Institute, charged by the Institute with the making of proposals for the 'modernization' of the provincial *Trustee Act*, has issued a report commending adoption of most of the features that

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[7]Uniform Law Conference of Canada, *Uniform Trustee Investment Act, 1997* (hereinafter referred to as "the Uniform Act"): http://www.ualberta.ca/alri/ulc/acts/etrust.htm

[8]Uniform Law Conference of Canada, *Proceedings of the Seventy-Eighth Annual Meeting* (1996) 51 and Appendix N: "Investment by Trustees: The Prudent Investor Rule Revisited".

[9]*An Act to Consolidate and Amend the Enactments Relating to Trustees and for Other Purposes*, S.N.S. 1994-95, c. 19.

[10]*An Act to amend the Trustee Act*, S.P.E.I. 1997, c. 51.

[11]*An Act to amend The Trustee Act and to make consequential amendments to other Acts*, S.S. 1998, c. 40, s. 3.

[12]A*n Act to amend red tape by amending or repealing certain Acts and by enacting two new Acts*, S.O. 1998, c. 18, Schedule B, s. 16 [proclaimed to come into force July 1, 1999].

are found in the model Act.[13].

Having considered the subject of the prudent investor rule and the *Uniform Trustee Investment Act, 1997*, we are in general agreement with adoption of the model Act. However, there are some changes which the Commission deems appropriate as well as the addition of features not contained in the model Act.

RECOMMENDATION 1

That Manitoba adopt in* The Trustee Act *the modern portfolio theory of investment, also known as the prudent investor rule.

RECOMMENDATION 2

That Manitoba effect the change by introducing into* The Trustee Act *the provisions of the* Uniform Trustee Investment Act, 1997*, subject to some substantive and some linguistic departures.

[13]British Columbia Law Institute, *Trustee Investment Powers* (Report #6, 1999).

CHAPTER 3

PROVISIONS OF THE *UNIFORM TRUSTEE INVESTMENT ACT, 1997* AND THEIR ADOPTION IN MANITOBA

A. GENERAL

There are three options. First, to say nothing further in the Act concerning the duties and considerations which prudence requires of the trustee whose instrument does not contain an express or implied power of investment. Secondly, to adopt the Uniform Act in its entirety, or, thirdly, to adopt that Act in the main but with such changes that are more compatible with Manitoba thinking.

On an examination of the Uniform Act, the Commission is of the view that the third course is the most appropriate.

With the advent during recent decades of currency value fluctuations throughout the world, the steady decline for over 20 years of the purchasing value of the Canadian dollar, and the more recent phenomenon of dramatically reduced interest rates, a situation which experts expect to continue, Canadian investors - whether acting for others or for themselves - have had to become more sophisticated in their understanding of the investment markets. The public's interest in the markets is evidenced today by the volume of attention paid to these matters by television business programs, press coverage and magazines. It has become evident that all trustees managing funds - securities and real estate - for the benefit of others must become aware of risk management and the reasons for the necessary diversification of investments within a portfolio of assets. Trustees, whether of large pension plan funds or small testamentary trust funds, can no longer assume fiduciary office and be or remain unaware of the importance of their obtaining skilled investment advice.

Well-drawn testamentary and family trust instruments today, like employee benefit trusts, will confer upon the trustees the authority to delegate their investment powers, and prudent trustees so authorized will do as the reasonable business person would do in the circumstances. They will empower the trustees to delegate investment selection and the timing of acquisitions and sales to qualified financial advisers whose business is knowing the markets. The very proliferation in Canada of 'mutual funds', each concerned with a different sector of the domestic or international investment market or with different investments within a sector, itself calls for expertise in 'fund' assessment and selection. The levels of fees the 'fund' managers charge, and the timing of their charging those fees to the investor, are further considerations that the informed

trustee, like all other investors, has to have in mind.[1]

It is sometimes suggested that trustees of small funds, that is, roughly between $50,000 and $200,000 (Canadian $), cannot afford or justify the services of professional advisers and of agents handling for their clients asset allocation and selection, acquisitions and sales. Prudence for such trust funds, it is said, amounts to selecting those fixed interest issues, such as government bonds and the saving certificates of 'sound' financial institutions, that offer - albeit in a poor market - the highest interest rates. Short term deposits, between 1 year and 5 years, staggered as to their maturities and renewals, thus constitute the 'spread' of the investments of such trusts.

However, experts advise that such a 'bottom up' approach to trust investment, whatever the size of the fund, means there is no perspective or at least adequate perspective of the overall performance of the fund or of its investment potential. A 'top down' style of investment would give that perspective; it starts with the value of the total fund and plans how return, i.e. interest and growth, can most productively be obtained, given the size of the fund, the liquidity requirements of the particular trust terms, and the trust's likely duration.

It has been demonstrated, and this argument the Commission is persuaded is sound, that today there is no safe haven for funds. "Prudence, discretion and intelligence"[2] stipulate trustee portfolio practices for funds between $50,000 and $200,000, as much as for funds larger than the latter amount. The modern conception of prudence requires a more explicit set of skills and considerations than has hitherto been associated with the prudent person rule, and it emphasizes that no trustees can responsibly ignore the 'top down' approach. For example, not only should trustees of small funds be considering how best they can prudently maximise their 'return' by obtaining diversification through 'mutual funds', they should be thinking of the common funds of trust corporations. The stability of the leading trust corporations of Canada, the balanced investment inside those common trust funds between growth and interest-bearing securities, and the fact that no choice has to be made between 'mutual funds' whose marketing promotional brochures increasingly reflect a competitive market, are of obvious value to the less skilled trustee. This is the way any statutory relaxation of the present no-delegation rule would be used by trustees of small funds who are apprehensive of entering the markets on their own.

It is for these reasons that the Commission commends the prudent investor rule. However, while there is much force in the contention that uniformity between the

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[1]See, for instance, on the 'mutual fund' industry, G. Stromberg, *Investment Funds in Canada and Consumer Protection: Strategies for the Millennium*, a review prepared for the Office of Consumer Affairs, Industry Canada (October, 1998). This report underlines the 'prudence, vigilance, and sagacity' that is called for in trustees in their investing in this market. See also: *Fales* v. *Canada Permanent Trust Co.*, [1977] 2 S.C.R. 302 at 318; 70 D.L.R. (3d) 257 at 270.

[2]*The Trustee Act*, C.C.S.M. c. T160, s. 73(2).

provinces and the territories is both advantageous and is best obtained by each jurisdiction adopting the Uniform Act as it stands, the Commission is unfortunately unable to agree with the Uniform Law Conference as to some provisions of the model Act, and in the light of some existing provisions in the Manitoba *Trustee Act* to accept that some of the model Act's provisions are necessary. The Uniform Act will therefore be discussed section by section.

The Commission would explain its approach in this way. It will be evident that the change proposed for the Act represents a move from prudence itself as the primary control and criterion for investment - this being the existing statement of *The Trustee Act* - to a practice regimen dictated by prudence. Whether all the characteristics of such a regimen should be or need to be set out in *The Trustee Act* is debateable. Where the law is in doubt, *The Trustee Act* should clearly provide, but otherwise it has to be remembered that *The Trustee Act* is essentially facultative legislation. Within the Commonwealth tradition it has not been seen by the various legislatures of this tradition as a codification or other form of A-Z on trusteeship. This role has been left to publishing houses and professional writing, to which must now be added the Internet, as the vehicles that can best describe current practice and the requirements of trust doctrine.

The Commission would note that in the recently expressed view of one of the Law Lords in England trustee prudence as required by the case law already necessitates attention being given in appropriate circumstances to the various modern portfolio duties. The trustee is prudent in the context of the economic present, not on the basis of what was good practice in times past.[3]

The Commission has therefore adopted for *The Trustee Act* a sparing approach in the extent to which the distinct elements of prudent portfolio investment need or should be enumerated or spelled out in the Act itself, and this will appear in the following pages. However, this is not to suggest that the Commission attaches less importance in practice to those elements or details that it would omit from, or in greater brevity record within, the Act. For the purposes of *The Trustee Act* the Commission would paint in the broad landscape of portfolio investing, encouraging the legal profession to examine for trustees the scope of the duties, powers and possibilities that such investing involves.

B. PROPERTY (OR ASSETS) IN WHICH THE TRUSTEES MAY INVEST

Subsections 01(1) and (2) of the Uniform Act provide:

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[3]Lord Nicholls of Birkenhead, 'Trustees and their broader community: where duty, morality and ethics converge' (1995) 9 Tr. L. Intern'l 71.

Investment of trust property

01. (1) A trustee may invest trust property in any form of property or security in which a prudent investor might invest including a security issued by a mutual fund as defined in the [name of statute in jurisdiction regulating securities].

(2) Subsection (1) does not authorize a trustee to invest in a manner that is inconsistent with the trust.

The Commission agrees with the Uniform Act that, unless the trust instrument expresses a contrary intent, trustees should be enabled to invest as prudence would suggest in any type of property, including 'mutual funds'.[4] However, the Commission is of the view that this object is currently attained by the existing section 68(1) of *The Trustee Act*.

RECOMMENDATION 3

***That, for the purpose of describing the fact that all assets of whatever kind should be subject to the portfolio investment method, section 68)(1) of* The Trustee Act should be retained.**

C. INVESTMENT CRITERIA

Subsection 01.(3) of the Uniform Act provides:

A trustee may have regard to the following criteria in planning the investment of trust property, in addition to any others that are relevant to the circumstances:

(a) general economic conditions;
(b) the possible effect of inflation or deflation;
(c) the expected tax consequences of investment decisions or strategies;
(d) the role that each investment or course of action plays within the overall trust portfolio;
(e) the expected total return from income and the appreciation of capital;
(f) other resources of the beneficiaries;
(g) needs for liquidity, regularity of income and preservation or appreciation of capital;
(h) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

The Commission recognizes that trustees should "have regard to criteria in planning the investment of trust property" and has no dispute with the eight specified criteria adopted by the Uniform Law Conference. However, it continues to be of the opinion, for reasons earlier advanced in this Report, that such criteria should appear in regulations to the Act, and not in the Act itself. In other words, *The Trustee Act* would retain its present silence on the subject. The Act would have as its task the adoption of the competence test of a prudent

[4]See, however, Stromberg, *supra* n. 1.

person investing a portfolio or fund of investments. The main characteristics of portfolio investment should be included in the statute, but in the Commission's view these criteria are sufficiently important enough to appear in regulations.

It is apparent that the Commission does urge government in the Province to issue regulations further to *The Trustee Act* when enacting any investment amendment to the Act.

Saskatchewan and Ontario both consider the trustee investment criteria so important that they have not only included the eight point list in their respective *Trustee Acts*[5] as the model Act would have it, but have gone beyond that Act and made it mandatory that every trustee whose investment is governed by *The Trustee Act* consider each of those points, together on each investment occasion with any other consideration that can be seen to be relevant. We attach no less importance to the criteria; its departure from those provinces and from the model Act, which would include the "guidelines" as optionally considered criteria, is due to our desire both to keep the Act to what we see as the essential elements, and to avoid putting any statutory fence around the concept of 'prudence'.

RECOMMENDATION 4

***That the criteria be issued in the form of regulations to* The Trustee Act.**

D. STANDARD OF CARE

Section 02 of the Uniform Act provides:

> **Standard of care**
> **02.** In investing trust property, a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

The Uniform Act adopts a single standard of care, that is, it adds no higher standard for professionals who hold out that they have special trusteeship skills. The Commission agrees with this position which accords with the reasons given by the British Columbia Commissioners in their report to the Uniform Law Conference.[6] In particular, the Commission believes that the statutory power of the court to withhold relief for trustee breach causing investment loss serves equally well to encourage professionals to demonstrate those special skills that they profess to have.

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[5] *An Act to amend The Trustee Act and to make consequential amendments to other Acts*, S.S. 1998, c. 40, s. 3; *An Act to amend red tape by amending or repealing certain Acts and by enacting two new Acts*, S.O. 1998, c. 18, Schedule B, s. 16 [proclaimed to come into force July 1, 1999].

[6] Uniform Law Conference of Canada, *Proceedings of the Seventy-Eighth Annual Meeting* (1996) 51 and Appendix N: "Investment by Trustees: The Prudent Investor Rule Revisited".

It is also recommended by the Uniform Law Conference that, instead of speaking of prudence in terms of how a person of prudence would act in administering the property of others, the Act should speak of "the care, skill, diligence and judgment that a prudent investor would exercise in making investments." The model Act does not define "a prudent investor" beyond referring to the attributes that such a person would exhibit and implying that this is a person who follows the portfolio theory of investment. Unfortunately, the Commission finds the model Act's description of prudence to be as abstract and therefore interpretationally as difficult for the average trustee as the language it rejects. As to adding "reasonable" to "prudent investor", as Saskatchewan does throughout its amendment[7] in adopting the model Act, and as Nova Scotia provides in section 3 of its *Trustee Act*,[8] it may be that both adverbs are unnecessary. It is arguable as to what greater meaning is thereby given. The joining of "reasonable" with "prudence" is certainly a frequent occurence in trust instruments, but the Commission is of the view that stress upon the various acts that a prudent person would follow in pursuing portfolio investment provides greater clarity. Section 3 of the Nova Scotia *Trustee Act* exemplifies such clarity.

RECOMMENDATION 5

That* The Trustee Act *be amended to provide that, subject to any express provision of the will or other instrument creating the trust, in investing money a trustee may, for the sound and efficient management of a trust, establish and adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments in order to avoid undue risk of loss and to obtain a reasonable return.

E. DIVERSIFICATION

Section 03 of the Uniform Act provides:

Diversification
03. A trustee must diversify the investment of trust property to an extent that is appropriate having regard to
(a) the requirements of the trust, and
(b) general economic and investment market conditions.

So important is diversification and asset allocation to portfolio investment that the model Act proposes that a trustee have a *duty* to diversify. However, section 03 continues by saying the duty exists "to an extent that is appropriate" having regard to the terms of the

[7] *An Act to amend The Trustee Act and to make consequential amendments to other Acts*, S.S. 1998, c. 40.

[8] *An Act to Consolidate and Amend the Enactments Relating to Trustees and for Other Purposes,* S.N.S. 1994-95, c. 19.

trust, and general market conditions.

The Commission finds this language puzzling. It neither says that a duty always exists, and in the event of loss occurring the burden is upon the trustee to show why, perhaps in the circumstances, diversification was not employed or sufficiently employed, nor does it say that in a portfolio investment context for the trustee to consider diversification is a prime obligation that is dictated by the need for prudence.

It is not difficult to imagine circumstances, other than adverse market conditions, when diversification is hardly, if at all, possible. For example, the trust fund is small or the trust terms require immediate and sustained sizeable payments to a needy beneficiary or beneficiaries. Such circumstances might well rule out anything other than short term bonds and saving certificates. To speak of 'a duty to diversify' in the presence of these not unfamiliar circumstances, and others of a similar nature, is in the Commission's view not helpful. The Commission is rather of the opinion that diversification is a consideration that is a part of prudence, and that the Act at most should say this. The reference to diversification in this manner would suitably tie in with the description of prudence that the Commission has previously stated in language taken from the Nova Scotia *Trustee Act*.

RECOMMENDATION 6

That* The Trustee Act *provide that, as part of prudence, the trustee should consider what diversification is appropriate as to asset allocation in the particular circumstances of the trust being administered.

F. ADOPTION OF AN INVESTMENT STRATEGY

Section 04 of the Uniform Act provides:

> **Trustee not liable if overall investment strategy prudent**
> **04.** A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessment of risk and return, that a prudent investor could adopt under comparable circumstancess.

This language was developed by the Uniform Law Conference in part drawing upon section 79 of Manitoba's *Trustee Act*.. The Commission considers section 79 adequately reflects the object of section 04, and that no change to the Act in this respect is required.

RECOMMENDATION 7

***That, in connection with the development by the trustee of an investment strategy for the particular trust being administered, section 79 of* The**

Trustee Act *should be retained.*

G. QUANTIFICATION OF A TRUSTEE'S LIABILITY FOR LOSS CAUSED BY HIS IMPRUDENCE

Section 05 of the Uniform Act provides:

> **Quantiification of trustee's liability when investment strategy imprudent**
> **05.** A court assessing the damages payable by a trustee for a loss to the trust arising from the investment of trust property may take into account the overall performance of the investments.

Section 79 deals with the first part of the so-called 'anti-netting rule'. This first part would require the acquisition or retention of each individual investment to have been in isolation a prudent act, regardless of how prudent has been the trustee's investment of the portfolio as a whole. The second part of the rule, which logically follows the first, prohibits the trustee from setting off loss incurred as a result of an imprudent investment against gains made through trust investment elsewhere in the portfolio.

The Manitoba Act does not expressly abolish this second part of the rule. On the other hand, the rationale for this part may seem to disappear given the abolition in section 79 of the first part. The Commission is of the opinion that, in order to put the matter beyond doubt, the second part should be expressly abolished.

Section 05 of the Uniform Act provides that a "court assessing the damages payable by a trustee for a loss to the trust from the investment of trust property may take into account the overall performance of the investments." However, though the running head to section 05 speaks of a "trustee's liability when investment strategy imprudent", it is not clear from the section whether the reference is to portfolio gain or trustee adherence to portfolio investment practices. Nor does the statutory language clarify what gain can be used for set-off. For example, may the court set off loss against gain made at any time in the past, and even if distributed to beneficiaries? Must the imprudent trustee or trustees have been the trustee or among the trustees when the gain was made? This latter question does not appear idle if one recalls that set-off is essentially concerned with preventing unfair magnification of the trust fund, rather than withholding 'punishment' of the trustee for his wrongdoing.

Section 05 leaves set-off to the discretion of the court. The Commission is of the view that the above considerations should also and expressly be described as being within the scope of the discretion.

RECOMMENDATION 8

That* The Trustee Act *should expressly state that, following a trustee's

breach of trust, so found, the trustee should be permitted to set off loss caused against gains made, whether or not in any such breach situation the gain or gains in question have been distributed to beneficiaries, when

(i) the gains in question conformed to prudence in the investment of a portfolio, and

(ii) the trustee in breach was a trustee of the trust in question when the gain or gains were made.

H. INVESTMENT ADVICE

Section 06 of the Uniform Act provides:

Investment advice

06. (1) A trustee may obtain advice in relation to the investment of trust property.

(2) It is not a breach of trust for a trustee to rely upon advice obtained under subsection (1) if a prudent investor would rely upon the advice under comparable circumstances.

In balancing risk and return trustees frequently seek advice from investment professionals. The existing law permits all trustees to retain agents to advise them whenever a reasonable person with business skills would do so. Having hired an agent, trustees will not be in breach of trust in following their advice, if they have personally and carefully selected the agent and, before taking action on the basis of that advice, have considered as would the reasonable business person the nature and quality of the advice they have been given. Trustees are not insurers; they are expected only to discharge their duties and exercise their powers in good faith and with "prudence, vigilance and sagacity", as Dickson J. (as he then was) stated in *Fales* v. *Canada Permanent Trust Co*.[9]

Nevertheless, the Uniform Law Conference is of the view that there is "some doubt" in the absence of an express power in the instrument as to whether trustees may seek and rely upon investment advice. Consequently, section 06 of the Uniform Act authorizes trustees to obtain investment advice, and to rely upon that advice if a prudent investor would rely upon that advice in comparable circumstances.

The Commission is unable to agree that such doubt exists. To seek advice is not to delegate; agents are usually hired because of their particular skills. Advice of all kinds is frequently sought by trustees. Nor does the existing law permit trustees to rely upon advice; the prudence they must demonstrate in the selection of agents is complemented by the prudence they must exhibit in assessing whether they should adopt or not follow the advice

[9]*Fales* v. *Canada Permanent Trust Co.*, [1977] 2 S.C.R. 302 at 318; 70 D.L.R. (3d) 257 at 270.

they have received. Subsections 06(1) and (2) state the present case law.[10]

In the Commission's opinion, the issue on the subject of investment advice is not whether advice can be obtained, but how stress can be placed by *The Trustee Act* upon the importance of advice in appropriate circumstances.

In many circumstances the seeking of advice will be vital, while in others it is unnecessary (e.g., the trustee is corporate and has access to in-house skilled investment advice) or the cost of obtaining advice is not justifiable (e.g., the trust is small and payments to the beneficiary are frequent and significant).

The Commission is of the view that the trustee should be under a statutory duty to consider, in the particular circumstances, whether advice should be taken. For instance, beneficiaries faced with portfolio loss or the absence of reasonably expected portfolio gain should be entitled to the benefit of a trustee duty. If it is established that no advice was sought when the investment conduct of the trustee is later questioned by the beneficiaries, the trustee would have a duty to discharge in showing why it was not sought.

RECOMMENDATION 9

That* The Trustee Act *provide that the trustees have a duty to consider whether in the particular circumstances they should obtain advice as to the investment of the trust property.

I. DELEGATION TO AGENTS OF INVESTMENT TASKS

Section 07 of the Uniform Act provides:

Delegation of authority with respect to investment

07. (1) In this section, "agent" includes a stockbroker, investment dealer, investment counsel and any other person to whom investment responsibility is delegated by a trustee.

(2) A trustee may delegate to an agent the degree of authority with respect to the investment of trust property that a prudent investor might delegate in accordance with ordinary business practice.

(3) A trustee who delegates authority under subsection (2) must exercise prudence in

(a) selecting the agent,l

(b) establishing the terms of the authority delegated, and

[10]In a Consultation Document entitled "Investment Powers of Trustees" issued by the U.K. Treasury Department in May 1986, proposing an unrestricted scope of investment, the Treasury states (at para. 31): "The standard required of a trustee by trust law includes a duty to take advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice, to act with the same degree of prudence.": United Kingdom, HM Treasury, London SW1P 3AG.

(c) monitoring the performance of the agent to ensure compliance with the terms of the delegation.

(4) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation

(5) A trsutee who complies with the requirements of subseciton (3) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(6) This section does not authorize a trustee to delegate authority under circumstances in which the trust requires the trustee to act personally.

(7) Investment in a security issued by a mutual fund as defined in [*name of statute in jurisdiction regarding securities]* or in a similar investment is not a delegation of authority with respect to the investmnet of trust property.

The Commission notes that, while Prince Edward Island[11] and Saskatchewan[12] have adopted the model Act's section 07 provision for delegation, Ontario[13] (as the third Canadian jurisdiction to incorporate Uniform Act sections into its *Trustee Act)* has not done so. In the absence of contrary provision in the trust instrument, Ontario permits delegation only to the extent of authorizing investment in 'mutual funds' and trust corporation common trust funds. The Commission also notes that during the Second Reading of the Saskatchewan *Trustee Act* amendment,[14] the official Opposition in the provincial Legislature attacked the proposed authority to delegate claiming that financial planners are today numerous, many having few qualifications for the job, that these planners will be making the crucial trust investment decisions, and that following authorized delegation there is no guarantee trustees will have chosen good advisers. At the same time no one will be responsible for how trusts are in fact managed.

The Commission has already observed that investors everywhere today are hiring investment consultants to assist in the now highly skilled and complex task of portfolio investment. Market offerings are many and call for a sophisticated understanding of sectorial differences, the scene is global and, as with personal RRSPs, opportunities are international; the Commission sees no way in which the Province can deny to trustees, alone among informed investors, the right to delegate to professionals, whose business is expertise in the market, tasks that the prudent business person in his or her own affairs would regard as responsibly delegated.

The pertinent question in the Commission's view is what informed behaviour trustees

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[11]*An Act to amend the Trustee Act*, S.P.E.I. 1997, c. 51.

[12]*An Act to amend The Trustee Act and to make consequential amendments to other Acts*, S.S. 1998, c. 40, s. 11 (new s. 44).

[13]A*n Act to amend red tape by amending or repealing certain Acts and by enacting two new Acts*, S.O. 1998, c. 18, Schedule B, s. 16 [proclaimed to come into force July 1, 1999].

[14]Legislative Assembly of Saskatchewan, Debates and Proceedings, Third Session, Twenty-Third Legislature, April 17, 1998. http://www.legassembly.sk.ca/hnasard/

must demonstrate in selecting their delegates, and what 'sagacious' steps they would take so that they are able to discharge their case law duty of supervising the activities of the appointed delegates. It is to be observed that the model Act does nothing to alter the trustees' case law duties; personal appointment and competent monitoring remain their responsibility. Delegation is not abdication; trusteeship does not become a sinecure.[15]

For the purposes of the Manitoba Act, the Commission supports adoption of subsections 07(1), (2) and (3). However, it would not recommend inclusion in the Manitoba legislation of subsections (4) and (5). Subsection (4) states that an agent exercising a delegated function owes a duty "to the trust" to exercise reasonable care to comply with the terms of the delegation. Understandably, given the true legal nature of a trust, Saskatchewan has changed that language to a duty "to the trustee". Saskatchewan has also added a duty "to the beneficiaries", however, supposedly because this appears to be the Uniform Law Conference's intended meaning in subsection (4).

The Commission regards subsection (4) as a matter of the law of agency, and it is of the opinion in any event that a duty of care is imposed upon agents towards their principals by existing contract law. As to whether there should be a direct liability of trustee-appointed agents to trust beneficiaries, the Commission would observe that, again under existing law, a beneficiary may bring action against a third party, which includes the trustee's agent. This would occur in most instances when the trustee is unwilling to sue. To put the matter of agent liability before the court the beneficiary joins the hostile trustee as a co-defendant.

Also under existing law a direct action is more a matter of third party rights under contract law, and potentially of tort liability. Loss may be the consequence to the trust fund of the acts of the trustee's agent, but Canadian courts have yet to consider whether *Hedley Byrne*[16] liability for economic loss should extend to such an agent at the direct suit of the injured beneficiary. Whether the Commission should pre-empt the question by recommending for or against a statutory direct action is a policy issue.

The British Columbia Commissioners noted in their report to the Uniform Law Conference[17] that the direct liability of agents to trust beneficiaries is a proposition that has practice ramifications going considerably beyond the present investment concerns. It seems to this Commission that the weighing of the policy arguments for and against that proposition should be preceded by extensive soundings of the Public Trustee's office and the fiduciary institutions as to these likely ramifications. Such soundings would be undertaken

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[15]This point is emphasized in the Consultation Document issued by the U.K. Treasury Department, *supra* n. 10. It is proposed (at para. 16) that trustees "will be given the same power to make an investment of any kind as they would if they owned the trust in their own right". However, para. 16 is careful to remind readers that all "the existing duties and standards of care established by trust law" will remain in place.

[16]*Hedley Byrne & Co. Ltd.* v. *Heller and Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).

[17]Uniform Law Conference of Canada, *supra* n. 6, Appendix N at 23.

as to delegation in any field of trustee agency work and in all delegation circumstances. This is not that occasion.

There is no need to examine here the existing trust law that imposes liability upon an agent who in bad faith receives trust property to which he has no entitlement or who participates in a trustee's breach of trust. Nor need this report discuss the right of the trust beneficiary to sue a third person who is party to a breach, joining the wrongdoing trustee as a co-defendant.

Subsection (5) states in principle the present law, as the Uniform Law Conference notes, and the Commission sees no need to put that law into statutory form. Given also the proposed language of subsection (5), other problems arise, but in large part they have already been discussed in this report and in the circumstances no more need be said. The Commission would omit subsection (5).

Subsection (6) provides for the trust instrument that expresses a contrary intent as to delegation. However, as implementation of this exception the Commission prefers an adaptation of the language adopted by Saskatchewan[18] - "when the terms of the [trust instrument or oral declaration of trust] expressly prohibit the trustee from delegating authority [concerning investment]".

RECOMMENDATION 10

That* The Trustee Act *include those provisions of the* Uniform Trustee Investment Act *(sections 07(1)-(3)) that, subject to contrary intent of the trust creator (section 07(6)), authorize delegation by a trustee of the fiduciary duties and powers of investment. Delegation would be permitted where the prudent investor would delegate, but always subject to personal selection of the delegate by the trustee, instruction of the delegate by the trustee, and the monitoring of delegate performance by the trustee.

[18] *An Act to amend The Trustee Act and to make consequential amendments to other Acts*, S.S. 1998, c. 40, s. 11 (new s. 44(6)).

J. CONSEQUENTIAL STATUTORY AMENDMENTS, AND TRANSITION

The Uniform Law Conference points out that a number of statutes in each province or territory adopt the investment power set out in *The Trustee Act*, and that any change to the latter's investment power impacts upon those statutes.

The Commission has concluded that, though section 2 of *The Interpretation Act*[19] of Manitoba would probably be held to produce the same effect, *The Trustee Act* should put the matter beyond question by providing that, subject to contrary provision in any statute, the Act, as amended by the proposed amendment Act on modern portfolio investment, applies to all existing Manitoba statutes that for their several purposes adopt the investment power of *The Trustee Act*. The application would be as of the day of Royal Assent or later proclamation of the amendment Act.

It is also proposed by the Uniform Law Conference that the Uniform Act provisions shall apply, subject to the terms of the trust instrument, to existing as well as future non-statutory trusts. Since modern portfolio investment enables trustees to improve the return on invested trust funds, the Commission is in agreement with this policy and recommends application of the amendment Act to these trusts, also as of the above mentioned date.

RECOMMENDATION 11

That, as of the date of Royal Assent or later proclamation of the proposed Trustee Amendment Act adopting modern portfolio investment, the Amendment Act expressly provide that, unless any statute provides to the contrary, the amendment apply to the then existing statutes that adopt the investment power of* The Trustee Act*; and that, as of the same date, subject to the terms of the trust instrument, the amendment Act apply to all existing as well as future non-statutory trusts.

[19] *The Interpretation Act*, C.C.S.M. c. I80.

CHAPTER 4

PROVISIONS ADDITIONAL TO THE *UNIFORM TRUSTEE INVESTMENT ACT, 1997*

A. MUTUAL FUNDS AND COMMON TRUST FUNDS

Those trustees whose fund is in excess of $500,000 (Canadian $) will probably be empowered by the trust instrument to delegate their investment decisions to professional money managers, and the fund will be directly invested in the market. However, as 'mutual funds' have become popular diversification instruments with the smaller investor concerned for his or her own savings, so trustees of smaller funds have shown considerable interest in these funds. Not only do trustees thereby escape the present very low interest rates on fixed interest securities, but thereby also they participate in "equities", which are capital growth securities. Where the trust instrument is silent as to delegation, a Canadian Court has held that this type of investment constitutes an unauthorized delegatory act.[1]

The Commission agrees with the Uniform Law Conference that 'mutual funds' (a term to be defined) should be assets that are statutorily available to trustees,[2] and would recommend the adoption in this respect of section 01 of the Uniform Act or a distinct provision such as subsection 27(3) in the amended *Trustee Act* of Ontario.[3] However, the Commission would not add, "or similar investments", as found in section 07(7) of the Uniform Act. It is trustees of smaller funds - often relatives or close friends of the testator or even settlor - who will turn to these investments, and for this reason the Commission is of the opinion that 'similar investments' should be described by type or might possibly be enumerated. Such description of approved 'similar investments' could appear either in *The Trustee Act* itself, or be set out in regulations under the Act. The draft Act (Appendix A) provides a description in section 68.6(b).

RECOMMENDATION 12

That* The Trustee Act *provide that mutual funds - the term being defined by reference to other legislation or in the Act - be made available to all

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[1] *Haslam* v. *Haslam* (1994), 114 D.L.R. (4th) 562 (Ont. Gen. Div. Ct.).

[2] *Uniform Trustee Investment Act, 1997*, http://www.ualberta.ca/alri/ulc/acts/etrusts/htm. As to investor consideration in investing in "mutuals", see, G. Stromberg, *Investment Funds in Canada and Consumer Protection: Strategies for the Millennium* , a review prepared for the Office of Consumer Affairs, Industry Canada (October, 1998).

[3] A*n Act to amend red tape by amending or repealing certain Acts and by enacting two new Acts*, S.O. 1998, c. 18, Schedule B, s. 16 [proclaimed to come into force July 1, 1999].

trustees for investment, subject to contrary intent.

The common trust funds of trust corporations offer to trustees of small funds access to diversification without those trustees having to enter the increasingly more sophisticated field of 'mutual funds' investment. Under section 76(2) of the Manitoba *Trustee Act* a trust corporation, whether a sole trustee or a co-trustee, may invest funds held in trust by the corporation in that corporation's common trust fund.

Subject to regulations under the Act, subsection (3) of the Act enables a trust corporation to agree with any non-corporate trustee holding funds in trust that that trustee will invest those funds in the corporation's common trust fund.

The Commission believes *The Trustee* Act thereby adequately provides for investment by any trustee who wishes to obtain diversification through such a common trust fund.

RECOMMENDATION 13

That as to investment by trustees in the common trust funds of trust corporations, subsections 76(2) and (3) remain in* The Trustee Act *as adequate enabling provisions.

B. CONFLICT OF LAWS: APPLICABILITY OF THE MANITOBA PRUDENT INVESTOR LEGISLATION

Suppose a trust is created in a Canadian 'legal list' or 1970 Uniform Law Conference prudent person jurisdiction, and is silent as to any power of investment. Though the express or implied governing law of the trust instrument will probably be the jurisdiction in which the trust was created, the investment of the trust fund is being carried out in Manitoba. This is a fact situation that would more likely occur when the trustee is a federally incorporated trust corporation with headquarters in Toronto or Calgary, and branches in each Canadian jurisdiction. If it is also supposed that the corporation has concentrated investment-skilled staff in Winnipeg, it may well be that for the trust in question investment decisions are being made in Winnipeg. National charities and non-profit institutions could be placed in a similar situation with a head office in a legal list or prudent person jurisdiction, and branches in other Canadian jurisdictions raising money and selecting investments at the location of the branch in question. The head office may be in Ontario where there is now a prudent investor rule but a very limited right of the trustee to delegate investment tasks. The Commission has recommended for Manitoba that delegation be permitted whenever the prudent investor would take that course.

Is the scope of the permitted investment selection for the trust governed by the governing law of the trust (e.g. British Columbia or Alberta) or the local law (i.e. Manitoba)?

The traditional case law rule of the conflict of laws is that the investment authority of trustees is determined by the law governing the administration of the trust. Should there be doubt or silence in the particular trust instrument, it is a matter of construction as to whether the creator of the trust intended investment to be governed in the case of movable property, such as securities, by the law of the original or subsequently changed place of administration, of the creator's domicile or, in the case of *inter vivos* trusts, of the jurisdiction of closest connection.[4] The Commission is of the view that where there is no express intent this situation as to which is the governing law for investment purposes is too uncertain in its outcome in any particular instance.

The Commission has reached the conclusion that, given the costs involved if there were to be in practice no uniformity within Manitoba as to investment of different trust funds, it is defensible for the Province so to provide in *The Trustee Act*. This would cover trust corporations operating in Manitoba and one or more Canadian jurisdictions, and also charitable trusts with a branch or branches within Manitoba and a head office in another Canadian jurisdiction. If such a corporation is acting as a trustee of a fund or investing on behalf of a non-corporate trustee, or such a Manitoba located branch of a charity has a head office in another jurisdiction, and in either case is engaged in investment decision-taking within Manitoba, the law of Manitoba should apply to that investment selection, management and trustee liability, unless the trust instrument expressly sets out a contrary intent.

RECOMMENDATION 14

That* The Trustee Act *provide that, where a trustee is operating in Manitoba plus one or more other jurisdictions and is engaged in investment decision-taking within Manitoba, the investment law of* The Trustee Act *of Manitoba, subject to contrary intent, shall apply to the trust in question, without regard, that is, to the law governing the administration of the trust.

RECOMMENDATION 15

That registered charities and non-profit institutions, whether organized by incorporation or trust, which are engaged in investment decision-taking within Manitoba, whether at a head office or branch office, shall be subject to the investment law of Manitoba, subject to the expression of a contrary intent in statute of another jurisdiction or the organization's documentation.

[4]W.F. Fratcher, ed., *Scott on Trusts* (4th ed.,1987) para. 618. See generally J.-G. Castel, *Canadian Conflict of Laws* (4th ed., 1997).

C. ETHICAL INVESTING

Section 79.1 of the present Act was enacted in 1995 further to a recommendation of this Commission.[5] The section provides that, subject to contrary intent of the trust creator, trustees may employ any "non-financial" criterion in the formulation of investment policy or in the selection of investments, provided that a prudent person could have made the same policy or selection decision.

While representations have been made to the Commission opposing the retention by the Act of this section, and that opinion was also stated in the circulated draft paper prepared for the Commission, we consider the section to have been so recent a recommendation of ours when the matter was fully discussed, that it is inappropriate, less than four years later, for us now to support its repeal. The Commission is not aware of any consideration, or therefore criticism, of this section in the courts.

RECOMMENDATION 16

That section 79.1 of* The Trustee Act *concerning the use of non-financial (i.e. ethical) criteria in investing be retained.

D. THE HOLDING OF TRUST ASSETS

Section 71 of *The Trustee Act* requires that trustees, other than trust companies registered and entitled to transact business as trust companies in Manitoba, shall cause the securities that they acquire to be registered in their names as the trustees of the particular trust. Also the securities "may be transferred only on the books of the security issuer or registrar in the names of the trustees as trustees for that trust estate".

This section, like that in other provincial Acts, was originally copied from 19th century English legislation. It is now extremely dated, because it fails almost totally to recognize today's electronic transfer of securities. Security transfers are currently all book-based. In the origination and transfer of stocks and bonds, in many instances no certificates are issued at all. If the client requires it, certificates can sometimes be obtained, but this raises costs to the trust because delays are caused and transactions cannot be closed in the three to five days that brokers have within which to complete 'trades'.

The Commission is of the view that legislation that in fact is simply being ignored,

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[5]*The Trustee Amendment Act*, S.M. 1995, c. 14; Manitoba Law Reform Commisison, *Ethical Investments by Trustees* (Report #79, 1993).

because of circumstantial change beyond the control of trustees, should be repealed.[6] Moreover, it is of the view that the rate of technological change is today so rapid that the text of the Act is no longer the appropriate location for provisions of this kind. If the security of the trust fund is the concern, regulations to the Act should be the vehicle for any alternative provision, when it becomes apparent what that alternative might effectively be.

RECOMMENDATION 17

That section 71 of* The Trustee Act*, requiring securities acquired as trust investments to be registered in the names of the trustees, be repealed as no longer reflective of the modern book-based system.

E. EVEN HAND AND TOTAL RETURN

A trustee of a trust with successive interests has a fundamental duty, subject to contrary intent expressed by the settlor in the trust documentation, to be impartial as between an income beneficiary and capital beneficiaries as remaindermen. This means that a trustee must so invest that he keeps an even 'return' balance between those entitled to income and those entitled to capital.[7]

The so-called even hand or impartiality rule is hard to apply because for today's circumstances of fluctuations in the nominal value and the declining purchasing value of currencies there is no precedent as to what an income beneficiary (for life or a term of years) is entitled to expect by way of a level of income, nor what the remaindermen may expect to receive by way of a capital sum on the income beneficiary's death. The courts are prepared only to look at the facts of each particular case, and rule on this basis as to whether the even hand rule was breached.

Moreover, the rule is 19th century in origin, and case law descriptive of it was handed down in the days prior to the mid-1960s when it was doctrinal throughout the common law world that the role of the trustee was to keep the capital 'safe' for the remainderman and to pay to the income beneficiary the income from 'prudent' investments. However, this approach led to uncertain results even in its day. For many years in the first half of the present century the percentage paid the income beneficiary in Canada was 4%, but the figure has been regarded by the courts as discretionary and various higher percentages were accepted at different times between the beginning of the century and 1973, when a court considered the appropriate figure to be 5%. The artificiality of these

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[6]This view was also adopted in a recent Report of the British Columbia Law Reform Institute, *Trustee Investment Powers* (Report #6, 1999) 18-19.

[7]See further D.W.M. Waters, *Law of Trusts in Canada* (2nd ed., 1984) 787-843.

percentages was well demonstrated in England. During the deflationary 1930s the then railway companies in England ran themselves close to insolvency in their determination to pay 4% dividends - these were paid out of reserves - and so maintain their *Trustee Act* investment status. 4% in other words did not reflect the true economic return.[8]

In 1970, when inflation was already of serious proportions, an Ontario Court[9] held that a life tenant was entitled to an annual income between 8% and 10% per annum. The interest rate payable on prime residential mortgages in Toronto was then 10%, and the Court noted also that between 8% and 9½% per annum was payable on good quality bonds. No mention was made of the impact of inflation upon the buying power of the capital, and whether part of such mortgage or bond interest should be reinvested as the inflation element in the interest rates cited. That is, the Court was evidently thinking still in terms of capital 'safely' invested, and the life tenant as entitled to the income that prudently invested capital would produce.

Much of the practical problem with the rule is that between the interests of income and capital beneficiaries there is an inevitable clash. The former expect the higher range of interest rates available on the fixed-interest securities market, while the capital beneficiaries compare the growth level of the capital with the Toronto Index or even the U.S. Standard and Poor's 500. Both classes of beneficiary are disappointed, and each seeks to fault the trustee. It will be apparent, however, that what is wrong is not the rule of equity that trustees must maintain a reasonable balance between the return that flows to each of the two classes of beneficiary, a rule that retains today as much force as it has always had, but that 'reasonable balance' determined with the concepts of income and 'safely' invested capital is no longer valid. The modern portfolio theory does not attack the principle of even hand; it merely replaces the notion of income (i.e., interest, rents, royalties and dividends) as the 'return', with another concept. That is that no investment at all can be valued other than in terms of risk and gain from the asset, and that investing for an entire trust portfolio or fund involves a balancing of risks across the spectrum of the investments so as to produce the highest level of return, defined now in terms both of income and growth, that is compatible with an acceptable level of overall risk.

Total return is a phrase that refers to the entire gain brought to the trust, whether it occurs in the form of accounting income or the appreciation in value of capital (or principal). The acceptability level dictated for trustees is prudence; the portfolio balance must be what a prudent person would accept. This allows a level of risk in the selection of individual investments, but even here the trustee must avoid the purely speculative. To define speculation in the context of portfolio investing is not easy because much depends on the size of the trust fund and the objects of the particular trust, but it would probably include investments such as derivatives (i.e. swaps, futures, and options) where the investment

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[8] *Ibid.*, at 769-770 and 817-818.

[9] *Re Smith* [1971] 1 O.R. 584, 16 D.L.R. (3d) 130 (H.C.); varied [1971] 2 O.R. 541, 18 D.L.R. (3d) 405 (C.A.).

instrument is a contract whose entire worth depends on a correct conjecture as to likely movements of the particular market.

The 'return' itself as between interests, rents, royalties, dividends ("interest") and growth ("equity") may sometimes be principally obtained from interest (e.g. a period of marked inflation), sometimes be equally obtained from interest and equity (e.g. a period of a lower level of inflation, and steadily increasing productivity), and sometimes be obtained principally from equity (e.g. today's circumstances of low inflation, stable labour costs, and in the United States at least high productivity). In following total return, instead of seeking maximum income or, as occurred in *Re Smith*,[10] maximum growth - each, of course, within the restraints of prudence - the investor (the trustee for present purposes) is not concerned *how* the gain (or return) is brought about in any period of time, but with the total quantum of gain.

The result of the adoption of total return investing, the logical consequence of the modern portfolio theory, is that impartiality or even hand can be achieved by the trustee much more easily, and in a manner that is more obviously explicable to and acceptable by both income and capital beneficiaries.

In the United States the aftermath of the widespread adoption of the modern portfolio theory has been five years of work by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") towards a revision of the *Uniform Principal and Income Act*. The 1997 revision mandates total return investing by trustees unless the instrument expresses a contrary intent, but an added central provision of the new Uniform Act is that the trustee is empowered in certain circumstances to allocate and adjust 'return' between the income and capital accounts. This allows the trustee to produce a 'reasonable balance' between the interests of income and capital (or principal) beneficiaries where the actual return of the return does not produce such a balance.[11] Understandably, such a follow-up to the adoption of modern portfolio investing - applicable, unless excluded, to all trusts with distinct income and capital beneficiaries - is a complete break with the past, and it has led to considerable debate.

In Manitoba, the Commission has taken note of the fact that the *Income Tax Act* (Canada) taxes 'income' and growth in 'capital', and, as the NCCUSL has recognized in revising the Uniform Principal and Income Act, the retention by federal or state taxing authorities of the 'income' and 'capital' distinction directly inhibits the introduction of the total return trust. Indeed, it necessitates the exclusion of total return investing where there will inevitably be conflict between the outcome of such private trust investing and the requirements of particular taxing provisions.

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[10]*Ibid.*

[11]This idea was recommended by the Ontario Law Reform Commission, *Report on the Law of Trusts* (1984) Vol. I, 298-300, under the description “Discretionary Allocation Trust”.

However, total return investing by charitable and non-profit institutions can be undertaken throughout Canada, as in the United States, without concern in most instances for even hand considerations. However, there will be such considerations where the charity has assumed title to property with the task of paying income to the donor for the donor's lifetime, the capital item to be taken in possession by the charity on the donor's death. Charities and non-profit institutions are not concerned with either the payment of income tax or capital gains tax. Registered bodies are exempt from such taxation; they are required only to adhere to the annual distribution stipulations set out in the *Income Tax Act* (Canada) and for Québec the tax legislation of that province. So advantageous has total return investing proved to be for endowment funds managed by Canadian community foundations and universities that have adopted it that the Commission recommends legislation be enacted permitting all charitable and non-profit bodies to invest endowment funds for total return unless the trust terms of any such fund expressly withhold such a power from the chariable or non-profit institution in question. This reverses the present rule that such charities and institutions may not distribute on a total return basis unless the endowment instrument in question permits such distribution.

On the other hand the Commission has reluctantly concluded, contrary to the decision in the United States of the NCCUSL, the American Bar Association, and already a number of enacting states, that authorization of total return investing, subject to express contrary intent, cannot be generally proposed for provincial legislation in Manitoba. Advantageous though the principle of total return might be, any statute to the same effect as the United States *Uniform Principal and Income Act*, which is now revised to include both modern portfolio theory and total return, runs into immediate problems with the provisions of the *Income Tax Act* (Canada). The donor can exclude even hand considerations; there is nothing he or she can do about the structuring of tax legislation by the state. In the Commission's view, the introduction of a statutory power, whereby all trustees of private trusts in Manitoba may (or must) invest for total return unless contrary intent is expressed in the trust instrument, has to await the time when the *Income Tax Act* (Canada) provides for the taxation of 'total return'.

However, there will be many trusts for which, for one reason or another, the present 'income' and 'capital' taxation regime is of small or no concern. Because of these trusts, the Commission agrees with the position taken by the *Report on the Law of Trusts* released by the Ontario Law Reform Commission in 1984.[12] Referring to the proposed revised *Trustee Act* (Ontario) the Ontario Commission stated:[13]

> we have concluded that the revised Act should include a facultative provision, which a settlor or testator would be free to adopt or to ignore [according to choice]..

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[12]*Ibid*., at 301-304.

[13]Ontario Law Reform Commission, *supra* n. 12, at 303.

The Ontario Commission continues:[14]

> Such a provision would set out a comprehensive percentage trust, and it would enable [those engaged in drafting] to adopt the statutory trust by expressly employing the words, 'on percentage trusts', in the trust instrument.

In so providing in their Report the Ontario Commission drew upon the precedent in England of section 33 of the *Trustee Act, 1925*, which with a similar shorthand reference permits the settlor or testator to introduce a 'protective trust' into his or her instrument. The total return trust is a new and largely untried concept in Canadian common law, and the precedents are from the United States, where the tax and often the drafting considerations are different. We have concluded that such a provision in the Manitoba *Trustee Act* as commended by the Ontario Commission would be of significant assistance to settlors and testators alike who wish and are able to take full or significant advantage of the modern portfolio theory of investment.[15]

RECOMMENDATION 18

That* The Trustee Act *carry provision enabling all charitable and non-profit institutions, whenever created, to invest endowment funds for total return unless the incorporation or trust documentation expressly withholds such a power.

RECOMMENDATION 19

That* The Trustee Act *contain a section setting out the structure of a percentage trust which the creator of any trust would be able to adopt by employing the term "on percentage trusts".

CHAPTER 5

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[14]Ontario Law Reform Commission, *supra* n. 12. The discretionary allocation trust, and the percentage trust both detach investment from the distribution obligation. That is the secret.

[15]Recent literature on the total return trust (or percentage or unitrust) includes R.B. Wolf, "Defeating the Duty to Disappoint Equally - The Total Return Trust" (1997) 32 Real Prop. Prob.& Tr. J. l 45; R.B. Wolf, "Total Return Trusts - Can Your Clients Afford Anything Less?" (1998) 33 Real Prop. Prob. & Tr. J. 131.

LIST OF RECOMMENDATIONS

The following are the recommendations contained in this Report.

1. That Manitoba adopt in *The Trustee Act* the modern portfolio theory of investment, also known as the prudent investor rule. (p. 10)

2. That Manitoba effect the change by introducing into *The Trustee Act* the provisions of the *Uniform Trustee Investment Act, 1997*, subject to some substantive and some linguistic departures. (p. 10)

3. That, for the purpose of describing the fact that all assets of whatever kind should be subject to the portfolio investment method, section 68)(1) of *The Trustee Act* should be retained. (p. 14)

4. That the criteria be issued in the form of regulations to *The Trustee Act*. (p. 15)

5. That *The Trustee Act* be amended to provide that, subject to any express provision of the will or other instrument creating the trust, in investing money a trustee may, for the sound and efficient management of a trust, establish and adhere to investment policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments in order to avoid undue risk of loss and to obtain a reasonable return. (p. 16)

6. That *The Trustee Act* provide that, as part of prudence, the trustee should consider what diversification is appropriate as to asset allocation in the particular circumstances of the trust being administered**.** (p. 17)

7. That, in connection with the development by the trustee of an investment strategy for the particular trust being administered, section 79 of *The Trustee Act* should be retained. (p. 18)

8. That *The Trustee Act* should expressly state that, following a trustee's breach of trust, so found, the trustee should be permitted to set off loss caused against gains made, whether or not in any such breach situation the gain or gains in question have been distributed to beneficiaries, when
   (i) the gains in question conformed to prudence in the investment of a portfolio, and
   (ii) the trustee in breach was a trustee of the trust in question when the gain or gains were made. (p. 19)

9. That *The Trustee Act* provide that the trustees have a duty to consider whether in the particular circumstances they should obtain advice as to the investment of the trust property. (p. 20)

10. That *The Trustee Act* include those provisions of the *Uniform Trustee Investment Act* (sections 07(1)-(3)) that, subject to contrary intent of the trust creator (section 07(6)), authorize delegation by a trustee of the fiduciary duties and powers of investment. Delegation would be permitted where the prudent investor would delegate, but always subject to personal selection of the delegate by the trustee, instruction of the delegate by the trustee, and the monitoring of delegate performance by the trustee. (p. 23)

11. That, as of the date of Royal Assent or later proclamation of the proposed Trustee Amendment Act adopting modern portfolio investment, the Amendment Act expressly provide that, unless any statute provides to the contrary, the amendment apply to the then existing statutes that adopt the investment power of *The Trustee Act*; and that, as of the same date, subject to the terms of the trust instrument, the amendment Act apply to all existing as well as future non-statutory trusts. p. 24)

12. That *The Trustee Act* provide that mutual funds - the term being defined by reference to other legislation or in the Act - be made available to all trustees for investment, subject to contrary intent. (pp. 25-26)

13. That as to investment by trustees in the common trust funds of trust corporations, subsections 76(2) and (3) remain in *The Trustee Act* as adequate enabling provisions. (p. 26)

14. That *The Trustee Act* provide that, where a trustee is operating in Manitoba plus one or more other jurisdictions and is engaged in investment decision-taking within Manitoba, the investment law of *The Trustee Act* of Manitoba, subject to contrary intent, shall apply to the trust in question, without regard, that is, to the law governing the administration of the trust. (p. 27)

15. That registered charities and non-profit institutions, whether organized by incorporation or trust, which are engaged in investment decision-taking within Manitoba, whether at a head office or branch office, shall be subject to the investment law of Manitoba, subject to the expression of a contrary intent in statute of another jurisdiction or the organization's documentation. (pp. 27-28)

16. That section 79.1 of *The Trustee Act* concerning the use of non-financial (i.e. ethical) criteria in investing be retained. (p. 28)

17. That section 71 of *The Trustee Act*, requiring securities acquired as trust investments to be registered in the names of the trustees, be repealed as no longer reflective of the

modern book-based system. (p. 29)

18. That *The Trustee Act* carry provision enabling all charitable and non-profit institutions, whenever created, to invest endowment funds for total return unless the incorporation or trust documentation expressly withholds such a power. (p. 33)

19. That *The Trustee Act* contain a section setting out the structure of a percentage trust which the creator of any trust would be able to adopt by employing the term "on percentage trusts". (p. 33)

This is a Report pursuant to section 15 of *The Law Reform Commission Act*, C.C.S.M. c. L95, signed this 22nd day of June 1999.

Clifford H.C. Edwards, President

John C. Irvine, Commissioner

Gerald O. Jewers, Commissioner

Eleanor R. Dawson, Commissioner

Pearl K. McGonigal, Commissioner

APPENDIX A

DRAFT TRUSTEE AMENDMENT ACT

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Manitoba, enacts as follows:

Short title

1. This Act may be cited as The Trustee Amendment Act, [year of the Act].

C.C.S.M., c. T160

2. The Trustee Act is amended by this Act.

3. Subsections 68(1) and 68(2) are repealed and the following are substituted:

Modern portfolio investment
68(1) A trustee, in investing and re-investing trust property, must in order to avoid undue risk of loss and to obtain a reasonable return, establish and adhere to investment policies, standards and procedures that a prudent person would apply in investing a portfolio of securities.

Authorized property for trustee investment
68(2) A trustee may invest or re-invest, further to subsection 68(1), in any kind of property, whether real or personal or mixed, including a security issued by a mutual fund as provided in section 74.

Diversification of investment
68.1 A trustee must consider whether the investment of the trust property should be diversified and if so in what manner, having regard to:
(a) the terms and the circumstances of the trust, including the total value of the trust property; and
(b) the general economic and investment market conditions.

An overall policy of investment
68.2 A trustee is not liable for loss arising from any investment if the trustee satisfies the court that:
(a) the investment was made as a result of an overall policy adopted by the trustee for the investment of the trust property; and
(b) the overall policy then in place was one that a prudent person would follow further to subsection 68(1).

Trustee entitlement to set-off

68.3 When a trustee has been found by a court to have acted in breach of trust with regard to investment, loss caused by the breach may be set-off against gains otherwise made in the investment of the trust property, whether or not those gains or part of the gains have been distributed to a beneficiary, provided:

(a) the trustee in breach was a trustee of the trust when gains that are proposed to be used for set-off were made; and\

(b) those gains were made when the trustee was acting as a prudent person further to subsection 68(1).

Investment advice

68.4 A trustee has the duty to consider whether in all the circumstances, including the trustee's level of knowledge and skill, to obtain advice with regard to the investment of the trust property.

Delegation by the trustee of investment authority

68.5 A trustee

(a) may delegate to a person other than a co-trustee the degree of authority with respect to the investment of trust property that a prudent person might delegate in the ordinary course of business; and

(b) must, in delegating authority under subsection (a) of this section, exercise prudence in:

  (i) selecting the person to whom delegation is made in order to ensure that the selected person has the required especial skill,

  (ii) establishing the terms of the authority delegated; and

  (iii) supervising the performance of the delegate in order to ensure compliance with the terms of the delegation.

Mutual funds

68.6 (a) Investment further to subsection 68(1) in a security issued by a mutual fund is a proper delegation of authority under subsection 68.5(a).

(b) For the purposes of this Act a mutual fund means an issuer of securities that entitles the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in a part of the net assets, including a separate fund or trust account, of the issuer of the securities.

(c) Investments of a similar nature to mutual funds may be authorized by the Lieutenant Governor in Council issuing regulations under this Act.

4. Section 71 is repealed.

5. Section 72(1) is repealed.

6. Subsection 72(2) is renumbered as section 72 and amended:

(b) prevents a trustee from doing anything that the trustee is expressly directed to do by the instrument creating the trust.

7. Subsection 73(1) is renumbered as section 73.

8. Subsections 73(2) and 73(3) are repealed.

9. Section 74(1), the final paragraph thereof, is amended:

in like manner as if the trustee were entitled to the securities beneficially, and may accept any securities of any denomination or description of the reconstructed or purchasing or new or other corporation in lieu of, or in exchange for, all or any of the original securities, if the new securities are securities in which a prudent person, further to section 68(1), would invest trust property.

10. Section 74(3) is amended:

Where a trustee has, in good faith, done any act or thing authorized under subsection (1), and if securities accepted by the trustee under the compromise, scheme or arrangement are securities in which a prudent person, further to section 68(1), would invest trust property, the trustee may retain the securities for any period for which the trustee could have properly retained the original securities.

11. The running head preceding section 75 and section 75 are repealed, and the following substituted:

The conflict of laws and trustee investment
75(1) Where a trustee is carrying out the terms of the trust instrument both in Manitoba and one or more other Canadian or foreign jurisdictions, and the trustee is making investment decisions, personally or by way of an agent or delegate, in Manitoba, the investment provisions of *The Trustee Act* apply to that trust instrument without regard to the law governing the administration of the trust.

Investment decisions of a registered charity or non-profit association
75(2) Where a registered charity or non-profit institution, whether organized by incorporation or trust or otherwise, is making investment decisions within Manitoba, whether at a head office or branch office, the charity or non-profit institution is subject to the investment provisions of *The Trustee Act*, provided that no contrary intent exists in a statute of the jurisdiction that constitutes the governing law of the charity or non-profit institution or in the formation documentation, including varied documentation, of the charity or institution.

75(3) Evidence of such contrary intent must be brought to the attention of the Public Trustee by any charity or non-profit institution claiming to be brought within the proviso to subsection (2) of this section.

PERCENTAGE TRUST

Allocation of receipts and outgoings

75.1(1) Where a trustee is expressly directed by the trust instrument to hold assets on percentage trusts, the trustee shall value the assets periodically and, instead of any income arising from the assets, pay to the person who would otherwise be the income beneficiary a percentage of that valuation in each year of the valuation period.

75.1(2) Where there are two or more income beneficiaries whose interested are vested in possession at the same time, the percentage shall be divided equally among them, unless the trust instrument divides the percentage in another proportion, or makes other provision, including discretionary trusts,, for the distribution of the percentage.

75.1(3) The percentage payment shall be made from income arising during the accounting year and, so far as income is insufficient, from capital, and any income of the trust arising during the accounting year in excess of the amount of the percentage payment shall be added to capital.

75.1(4) In this section

(a) "assets" means the capital of the trust property subject to the percentage trusts, plus the income arising therefrom on hand, accumulated and accrued on valuation day;

(b) "valuation" means the fair market value of the assets less the liabilities outstanding at the moment of valuation; and

(c) "valuation period" means the period of time between one valuation and the next.

75.1(5) Where the trust instrument does not provide for the frequency of valuations or for the percentage to be paid annually during a valuation period, the Lieutenant Governor in Council may make regulations under this Act providing therefor.

75.1(6) The Lieutenant Governor in Council may also make regulations under this Act for such purposes concerning percentage trusts as are considered appropriate.

75.1(7) A testator or settlor in employing this section is not precluded from conferring upon the trustee or other person a power to encroach upon capital in favour of a beneficiary.

CHARITABLE OR NON-PROFIT ENDOWMENT FUNDS

Total return distribution of endowment funds

75.2(1) Where a registered charity or non-profit institution as described in subsection 75(2) holds any endowment fund in Manitoba, the charity or institution may distribute on a total return basis, unless the terms of the endowment are expressly to the contrary.

75.2(2) A charity or institution intending to distribute in accordance with subsection (1) of this section is to determine what percentage of total return can prudently be distributed annually.

75.2(3) For the purpose of any determination with regard to percentage distribution, the charity or institution is to be governed by section 75.1 of this Act, unless and to the extent that the terms of the endowment provide otherwise.

75.2(4) In this section

(a) "endowment fund" means an asset or aggregation of assets that is solely furthering an object or objects of the charity or institution, the capital of which asset or aggregation is held as an investment or is in the process of investment by the charity or institution and, without benefit of this section, the income only of which may be distributed in furthering the object or objects;

(b) "total return" means the total of all increase of the fund as is obtained during the particular period without regard to whether such increase has been obtained in the form of income of any kind or of growth in the value of capital.

75.2(5) This section applies to any registered charity or non-profit institution, and any endowment fund, whether or not the charity or institution, or the fund, is existing at the time when this section comes into force.

12. Section 79.1 is renumbered as section 68.7 and amended:

Use of non-financial criteria

68.7 A trustee who uses a non-financial criterion to formulate an investment policy or to make an investment decision does not thereby commit a breach of trust if, in relation to the investment policy or investment decision, the trustee exercises the judgment and care that a prudent person, further to section 68(1), would exercise in investing trust property.

Coming into force

13. This Act comes into force on the day it receives the royal assent.

APPENDIX B

THE TRUSTEE ACT, C.C.S.M. c. T160

SECTIONS 68 TO 79.1

TRUSTEE INVESTMENTS

Authority of trustee to invest
68(1) Subject to any express provision of the law or of the will or other instrument creating the trust or defining the duties and powers of the trustee, and subject to subsection (2), a trustee may invest in any kind of property, real, personal or mixed.

Standard of care
68(2) Subject to any express provision of the will or other instrument creating the trust, in investing money for the benefit of another person, a trustee shall exercise the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

Corporation offerings
69(1) Where a conditional or preferential right to subscribe for any securities in any corporation is offered to trustees in respect of any holding in the corporation, they may, as to all or any of the securities,

(a) exercise the right and apply capital money subject to the trust in payment of the consideration, or

(b) renounce the right; or

(c) assign for the best consideration that can be reasonably obtained the benefit of the right or the title thereto to any person, including a beneficiary under the trust;

without being responsible for any loss occasioned by any act or thing so done by them in good faith, but the consideration for any such assignment shall be held as capital money of the trust.

Consent to exercise of power
69(2) The powers conferred by this section are exercisable subject to the consent of any person whose consent to a change of investment is required by law or by the instrument, if any, creating the trust.

Deposit of trust moneys
70(1) A trustee may, pending the investment of any trust money, deposit the trust money, during such time as is reasonable under the circumstances,

(a) in any bank; or

(b) in any trust company, loan company or credit union that is a member institution as

defined in the Canada Deposit Insurance Corporation Act (Canada).

Deposits

70(2) Where a trustee (other than a trust company registered and entitled to transact business as a trust company in Manitoba) deposits trust moneys under subsection (1), the trustee shall open and keep a separate account in the name of the trustee in the bank or other depository for each trust for which moneys so deposited are held.

Investment to be in trustee's name

71 Except in the case of a security that cannot be registered, trustees (other than trust companies registered and entitled to transact business as trust companies in Manitoba) who invest securities shall require the securities to be registered in their names as the trustees for the particular trust for which the securities are held and the securities may be transferred only on the books of the security issuer or registrar in the names of the trustees as trustees for that trust estate.

Instrument creating trust

72(1) The powers of trustees to invest conferred by this Act are in addition to the powers conferred by the instrument, if any, creating the trust.

Trust instrument to govern

72(2) Nothing in this Act relating to trustee investments

(a) authorizes a trustee to do anything that the trustee is in express terms forbidden to do, or to omit to do anything that the trustee is in express terms directed to do, by the trust instrument creating the trust; or

(b) prevents a trustee from doing anything that the trustee is specifically directed to do by the instrument creating the trust.

Changing investments by trustee

73(1) A trustee, in his discretion, may

(a) call in any trust funds invested in securities and invest them in other securities; and

(b) vary any investment by selling the securities in which the investment is made and investing the proceeds in other securities.

Limitation of liability

73(2) No trustee is liable for any breach of trust by reason only of continuing to hold an investment that since the acquisition thereof by the trustee has ceased to be an investment authorized by the instrument creating the trust or has ceased to be an instrument in which a trustee, exercising the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, would invest trust moneys.

Excess investments

73(3) Where a trustee has advanced more trust money on a mortgage than a trustee, exercising the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, would advance on that mortgage, the

security shall be deemed to be an authorized investment for any smaller amount that a trustee exercising that degree of judgment and care would have advanced on that mortgage, and the trustee is only liable to make good that portion of the amount actually advanced in excess of that smaller amount with interest.

Concurrence in compromise

74(1) A trustee holding securities of a corporation in which the trustee has properly invested the trust funds may concur in any compromise, scheme or arrangement

(a) for the reconstruction or re-organization of the corporation; or

(b) for the winding-up or sale or distribution of the assets of the corporation; or

(c) for the sale of all or any part of the property and undertaking of the corporation to another corporation; or

(d) for the amalgamation of the corporation with another corporation; or

(e) for the release, modification, or variation of any rights, privileges, or liabilities attached to the securities or any of them; or

(f) whereby

(i) all or a majority of the shares, stock, bonds, debentures, and other securities of the corporation, or of any class thereof, are to be exchanged for shares, stock, bonds, debentures, or other securities of another corporation, and

(ii) the trustee is to accept the shares, stock, bonds, debentures or other securities of the other corporation allotted to the trustee pursuant to the compromise, scheme or arrangement;

in like manner as if the trustee were entitled to the securities beneficially, and may accept any securities of any denomination or description of the reconstructed or purchasing or new or other corporation in lieu of, or in exchange for, all or any of the original securities, if the new securities are securities in which a trustee, exercising the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, would invest trust moneys.

Limitation on liability

74(2) A trustee is not responsible for the loss occasioned by any act or thing done in good faith under subsection (1).

Retention of securities acquired under subsec. (1)

74(3) Where a trustee has, in good faith, done any act or thing authorized under subsection (1), if securities accepted by the trustee under the compromise, scheme or arrangement are securities in which a trustee, exercising the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, would invest trust moneys, the trustee may retain the securities for any period for which the trustee could have properly retained the original securities.

Duty of trustee to take care

75 Nothing in this Act relieves a trustee of the duty

(a) to take reasonable and proper care with respect to investments authorized under this Act or by the instrument creating the trust and with respect to any other transaction authorized under this Act; or

(b) not to make any investment of trust money that, although an investment in which a trustee, exercising the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, would make is under any law in force in the province, an unlawful investment of trust money.

COMMON TRUST FUNDS

Definitions

76(1) In this section,

"interested person" means a person who has a financial interest in a common trust fund, and includes the member of the Executive Council charged by the Lieutenant Governor in Council with the administration of this Act and the member of the Executive Council charged by the Lieutenant Governor in Council with administration of Part XXIV (Trust and Loan Corporations) of The Corporations Act;

"trust corporation" means a trust corporation authorized to carry on business as such within the province.

Common trust funds authorized

76(2) Notwithstanding this or any other Act of the Legislature, a trust corporation that has capacity to do so may, unless the trust instrument otherwise directs, invest trust moneys in one or more common trust funds of the trust corporation and where trust money is held by the trust corporation as a co-trustee, the investment thereof in a common trust fund may be made by the trust corporation with the consent of its co-trustees whether the co-trustees are individuals or corporations.

Investment by other trustees

76(3) Subject to the regulations, a trust corporation may enter into an agreement with a trustee, other than another trust corporation, for the inclusion of any trust funds held by that trustee in a common trust fund of the trust corporation.

Regulations

76(4) The Lieutenant Governor in Council may make regulations with respect to

(a) the establishment, operation and termination of common trust funds;

(b) the investment of moneys in common trust funds;

(c) the auditing of common trust funds;

(d) the form in which accounts are to be filed in court for the purpose of passing accounts under this section;

(e) the service and publication of a notice under subsection (8); and
(f) information to be served with a notice under subsection (8).

Passing of accounts in court
76(5) A trust corporation may at any time file and pass accounts in the court relating to its dealings with respect to a common trust fund and, subject to this section, the court has the same duties and powers in respect of the accounts as it has in respect of the accounts of an executor.

Interested person may apply to court
76(5.1) On the application of an interested person, the court may, subject to subsection (5.2), order a trust corporation to pass accounts in the court relating to its dealings with respect to a common trust fund, and where the court so orders it has, subject to this section, the same powers and duties in respect of the accounts as it has in respect of the accounts of an executor.

Limit on frequency of passing accounts
76(5.2) A trust corporation shall not be required to pass accounts under subsection (5.1) more often than once in each 36 months.

76(6) Repealed, S.M. 1992, c. 29, s. 22.

Accounting only required under this section
76(7) Notwithstanding any other Act of the Legislature, a trust corporation is not required to render an account of its dealings with a common trust fund except as provided in this section or the regulations.

Notice of time and place for passing accounts
76(8) Where accounts are filed in the court under this section, the court shall fix a date, time and place for the passing of the accounts, and the trust corporation filing the accounts shall, at least 14 days before the fixed date,

(a) serve, in accordance with the regulations, a notice of the date, time and place, together with such other information as is prescribed by regulation, on such persons as the court directs; and
(b) publish the notice in accordance with the regulations.

Form of account
76(9) For the purposes of any passing of an account under this section, an account may be filed in the form prescribed in the regulations and shall be accompanied by the certificate of a qualified auditor certifying as to all matters prescribed in the regulations.

Appearance and expenses of interested person
76(10) An interested person has the right to appear in court personally or to be represented by counsel at the passing of accounts under this section, and the court may order

any expenses incurred by an interested person in respect of the passing of accounts to be charged against the income of the common trust fund or, where the available income is less than the amount of the expenses, to be charged in whole or in part against the principal of the common trust fund.

Effect of passing accounts

76(11) Accounts approved by the court under this section are, except with respect to any mistake or fraud shown in the accounts, binding and conclusive upon all interested persons as to all matters shown in the accounts and as to the administration of the common trust fund by the trust corporation for the period covered by the accounts.

Costs to be charged to common trust fund

76(12) The costs incurred by a trust corporation in respect of passing accounts under this section shall be charged against the income of the common trust fund and, where the available income is less than the amount of the costs, the court may order the excess amount to be charged against the principal of the common trust fund in accordance with the direction of the court.

PROTECTION AND INDEMNITY

Act protects anything done under it

77 This Act, and every order purporting to be made under it, is a complete indemnity to all persons for any acts done pursuant thereto; and it is not necessary for any person to inquire concerning the propriety of the order, or whether the court by which it was made had jurisdiction to make it.

Trustee not answerable

78 A trustee is chargeable only for money and securities actually received by him, notwithstanding his signing any receipt for the sake of conformity, and is answerable and accountable only for his own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any banker, broker, or other person with whom any trust moneys or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless it happens through his own wilful default; and may reimburse himself, or pay or discharge out of the trust property, all expenses incurred in or about the execution of the trusts or powers.

Defence based on investment policy

79 In an action against a trustee for failing to exercise, in respect of a particular investment, the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others, the trustee is not liable for loss arising from that particular investment if he satisfied the court

(a) that the investment was made as the result of a general policy of investing the funds making up the trust property; and

(b) that the general policy was not speculative and was a policy which a person of

prudence, discretion and intelligence would follow if he were administering the property of others.

Use of non-financial criteria

79.1 Subject to any express provision in the instrument creating the trust, a trustee who uses a non-financial criterion to formulate an investment policy or to make an investment decision does not thereby commit a breach of trust if, in relation to the investment policy or investment decision, the trustee exercises the judgment and care that a person of prudence, discretion and intelligence would exercise in administering the property of others.

APPENDIX C

LIST OF INDIVIDUALS AND ORGANIZATIONS TO WHOM THE DRAFT PAPER WAS CIRCULATED AND OF THOSE WHO RESPONDED

RECIPIENTS:

Gwen Hatch, Chair, Wills and Trusts Subsection, Manitoba Bar Association

Irene A. Hamilton, Q.C., Public Trustee of Manitoba

Brenda Bracken-Warwick, Regional Director, Canadian Bankers Association

Mr. Paul Muir, President, Manitoba Chapter, Canadian Association of Financial Planners

M. Normand Collet, Président, Fédération des Caisses Populaires du Manitoba

Mr. Stan Starr, President, Credit Union Central of Manitoba

Prof. D.T. Anderson, Faculty of Law, Robson Hall, University of Manitoba

Prof. Philip Osborne, Faculty of Law, Robson Hall, University of Manitoba

Dean J.L. Gray, Faculty of Management, Drake Centre, University of Manitoba

Mr. Richard Frost, Executive Director, The Winnipeg Foundation

Mr. Stanley G. Farwell, practising lawyer, Winnipeg, MB

Hon. V.E. Toews, Minister of Justice and Attorney General, Province of Manitoba

Bruce MacFarlane, Q.C., Deputy Minister of Justice and Attorney General, Province of Manitoba

Mr. T. Hague, Assistant Deputy Minister, Department of Justice, Province of Mantioba

Arthur Close, Q.C., Executive Director, British Columbia Law Institute

Peter J.M. Lown, Q.C., Director, Alberta Law Reform Institute

Anne Jackman, Executive Director, Law Reform Commission of Nova Scotia

Hon. Michael Radcliffe, Q.C., Minister of Consumer and Corporate Affairs, Province of Manitoba

Hon. John T. Nilson, Q.C., Minister of Justice and Attorney General, Province of Saskatchewan

Wolfe Goodman, Q.C., practising lawyer, Toronto, ON

Roderick A. Macdonald, Q.C., President, Law Commission of Canada

Heather Hisey, practising lawyer, Toronto, ON

Peter O. Jachetta, Public Trustee Office, Province of Manitoba

John P. Cochrane, Q.C., practising lawyer, Kentville, NS

Rodney Hanks, practising lawyer, Kentville, NS

Paul Milne, practising lawyer, Hamilton, ON

Carolyn Bodnar-Evans, Director, Finance and Administration, Canadian Cancer Society, Toronto, ON

RESPONDENTS

Wolfe D. Goodman, Q.C., Goodman and Carr, Toronto, ON

Bruce A. MacFarlane, Q.C., Deputy Minister of Justice and Deputy Attorney General, Province of Manitoba

Fiduciary Committee, Canadian Bankers Association

Hon. John T. Nilson, Q.C., Minister of Justice and Attorney General, Province of Saskatchewan

Hon. Michael Radcliffe, Q.C., Minister of Consumer and Corporate Affairs, Province of Manitoba

REPORT ON TRUSTEE INVESTMENTS
THE MODERN PORTFOLIO THEORY

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

INTRODUCTION

All trusts in favour of family members, friends, charities, or others will be designed to last for a period of time. This is so whether the trust is *inter vivos* (a living trust) or is contained in a will (testamentary). For example, the period may be the lifetime of a surviving spouse after which the children of the marriage take the capital. It may be the minority of a young grandchild to provide a lump sum of capital at 18 years of age, or perhaps 21 or 25, with a gift over to siblings, or the lifetime of an elderly or incapacitated person with a gift over to other dependants. It may be an outright gift of capital or a legacy to charities to take effect on the ending of certain family lives. The trust may create an endowment fund for the provision of scholarships and bursaries at a school, college or university.

There are all sorts of possibilities, but in each case the trustees have a duty to make the trust property as productive as possible over the intended lifetime of the trust in order better to achieve the trust objects. When the trust property is in the form of a fund or under the terms of the trust may be converted at discretion into cash, the trustees must invest. And that means invest wisely.

The Report deals with the problem where the creator of the trust, though having in law the right to determine the width of the investment power, has been silent. Professionally drawn trust deeds and wills almost always provide for the kinds of assets in which the trustees may invest, but often, especially in older, short form, or home-drawn instruments, such a clause is absent.

REFORM: THE MODERN PORTFOLIO THEORY OF INVESTING

For many years, inspired by 19th century experience, *The Trustee Act* of Manitoba, like that in all the provinces, contained a list of permitted trustee investments for those cases where the trust instrument said nothing. The trouble with these lists was that they were essentially restricted to government debt instruments. Inevitably therefore they were highly vulnerable to inflation and the decline of currency value, and always - it seemed - out of date. So, in 1983 Manitoba replaced the list with the rule that trustees may invest as the prudent person would do in managing the property of others. That is the rule that exists in *The Trustee Act* today.

The difficulty with this rule has proved to be that it is too indefinite, and as a consequence legal list thinking has continued. Courts in all prudent person jurisdictions have spoken of keeping capital ‘safely’, and of not ‘speculating’ in equity stock. In days of

high inflation, the courts were still inclined to award an income beneficiary the current interest rate, without concern for what was the real return.

As a result, in the United States about 15 years ago, a movement began among investment professionals and lawyers to spell out what 'prudence' means in contemporary market investment practice. The 'modern portfolio theory' or 'prudent investor' rule, as it was named, rejects the requirement, still existing in Manitoba, that each trust investment asset that is acquired must itself satisfy the test of prudence as if it were the sole trust asset. The theory adopts the principle of portfolio investment. That is, prudence is measured on how the investor handles the investment portfolio taken as a whole.

Today every asset is recognized as involving risk, whether it is debt or growth stock, and the task of every investor is to balance risk across the spectrum of investments within the portfolio. No asset is automatically excluded. In that regard, the investor is concerned only that the risk involved in an individual would-be investment asset is not so considerable, despite the gain potential, that even within a portfolio to purchase that asset would be 'speculation' rather than 'investment'.

For trustees, that risk be balanced is a duty. The trustees, in investing, must always be 'prudent' and 'sagacious', as the courts say, but now the trustees should be managing investment with a more complex idea in mind. They should be watching the markets and adjusting the 'mix' of assets held so that the trust fund is at its most efficient. Moreover, they will pursue this policy, not just in order to satisfy present requirements, but to meet projected return needs over the likely duration of the trust.

REFORM IMPLEMENTATION

Many states in the United States have already statutorily adopted the modern portfolio investment rule, and the Trustee Acts of Nova Scotia, Prince Edward Island, Saskatchewan and Ontario now authorize that same investment approach. It has also been recommended for British Columbia. All the legislating provinces, save Nova Scotia which amended its Act earlier, have adopted all or most of the provisions of the *Uniform Trustee Investment Act* adopted by the Uniform Law Conference in 1997.

The Commission recommends that in the main, the same Uniform Act be adopted in Manitoba. Recommendations are made for variation of the language of that model Act where the Commission considers it appropriate.

PROPOSED ADOPTION IN MANITOBA OF MODERN PORTFOLIO INVESTING

As a consequence, the Commission would introduce the principle of the modern portfolio theory of investment to take the place of the prudent person rule. The Commission makes the recommendation that criteria to guide trustees in such investing be introduced by way of regulations under *The Trustee Act*, and that for each trust - on its taking effect or this proposed reform coming into force - an investment strategy be designed by the trustees. It is also proposed that there be a duty upon trustees to consider the need in the particular trust for diversification.

Subject to appointment and monitoring safeguards, trustees would also be permitted to delegate their investment task to experts, including managers of mutual funds. Whether there can be delegation is to be determined by the circumstances in which, and the extent to which, the careful investor would delegate. Similarly, as would the responsible investor, the trustees must consider whether they should retain the advice of experts for any investment purpose.

One result of Manitoba adopting this approach to investment would be that, when a trustee has been found by a court to have culpably caused loss as a result of investments made, the amount of that loss may be set-off against gains otherwise properly made in investment. The present Act is silent on the point.

Other Manitoba statutes that adopt the investment power of *The Trustee Act* would also be read as authorizing modern portfolio investing.

OTHER ASSOCIATED REFORM PROPOSALS

In addition, the Commission recommends in this Report a number of new provisions that go beyond the *Uniform Trustee Investment Act*.

Where investment is being conducted within Manitoba, it is proposed that, subject to contrary intent of the creator of the trust, modern portfolio investing be authorized by *The Trustee Act* though the particular trust is operating in two or more jurisdictions and the governing law IS not that of Manitoba. This would considerably ease the task of professional trustees with numbers of trusts under their care. The Report goes on to recommend that charitable and non-profit organizations, whether trusts or corporations, that operate in two or more jurisdictions, and are conducting investment in Manitoba, have the same authority.

Two other recommendations are emphasized in the Report. First, that for endowment funds so-called ‘total return’ distributions (i.e., distributions in favour of trust fund objects without regard to the nature of the return, whether income or capital) be permitted to all charitable and non-profit organizations engaged in investment within Manitoba. Each organization that wishes to take advantage of *The Trustee Act* in this respect would then need to determine for the trust in question a percentage of return that may be expended each year,

and how often that percentage figure shall be reviewed.

The second is complementary. It is designed to assist all those who wish to introduce 'total return' and therefore 'percentage' trusts into their deed or will instruments. These are trusts where the 'income' beneficiary takes instead a percentage, say 5%, of the interest, dividends, rents, royalties, and growth in capital value arising in the year. Alternatively, such a predetermined percentage is expended in the year upon the particular charitable purpose or purposes which an endowment fund of a registered charity or non-profit institution is furthering.

The Trustee Act would have a section describing the nature and operation of a percentage trust, and the trust creator can adopt this provision with three words - "on percentage trusts".

DRAFT LEGISLATION

The Commission has also included in its Report a draft *Trustee Amendment Act*.

June, 1999
Report #101

SOMMAIRE DU RAPPORT SUR

LES PLACEMENTS PAR LES FIDUCIAIRES

SOMMAIRE

INTRODUCTION

Toute fiducie constituée en faveur des membres de famille, amis, charités, ou autres, sera destinée à durer pendant un certain temps. Ceci est vrai, que la fiducie soit constituée *inter vivos* (une fiducie vivante) ou qu'elle soit constituée par un testament (une fiducie testamentaire). Par exemple, la durée pourrait être la vie d'un époux survivant après laquelle les enfants du mariage prendraient le capital. Elle pourrait être la minorité d'un jeune petit-enfant qui bénéficierait d'une somme forfaitaire de capital à l'âge de dix-huit ans ou peut-être vingt-et-un ou vingt cinq ans, et à défault, ses frères et soeurs, ou la vie d'une personne âgée ou incapacitée et à défault aux personnes à charge. La fiducie pourrait être une donation ou un legs à une charité qui prendrait effet à la fin de la vie de certains membres d'une famille. La fiducie pourrait créer une dotation de bourses à une école, un collège ou une université.

Il existe toutes sortes de possibilités mais dans chaque cas, les fiduciaires ont une obligation de gérer le patrimoine fiduciaire de manière à le rendre aussi fructueux que possible pendant la durée de la fiducie afin de mieux atteindre ses objectifs. Lorsque le patrimoine prend la forme d'un fonds ou peut être, à la discretion des fiduciaires, converti en espèces selon les termes de l'acte constitutif, les fiduciaires doivent investir. Tout investissement ou placement doit être effectué prudemment.

Le rapport traite du problème où le constituant de la fiducie, même si en droit il peut déterminer les paramètres du pouvoir de placement, n'a rien prévu à ce sujet. Les actes constitutifs qui sont rédigés par des professionnels ainsi que les testaments, prévoient la plupart du temps les biens et valeurs mobilières dans lesquels les fiduciaires peuvent placer mais souvent, et surtout en ce qui concerne les vieux instruments pro forma ou ceux rédigés par les particuliers, une telle provision n'existe pas.

RÉFORME: LA THÉORIE MODERNE DU PORTEFEUILLE DE PLACEMENT

Pendant plusieurs années, inspirée par l'expérience du dix-neuxième siècle, *La loi sur les fiduciaires* du Manitoba comme celle de toutes les provinces, comportait une liste des placements autorisés par le fiduciaire lorsque l'acte constitutif ne prévoyait rien. Ces listes posaient des problèmes dans la mesure où elles étaient essentiellement limitées aux obligations gouvernementales. Ces obligations étaient inévitablement assujetties à l'inflation et au déclin de la valeur d'argent et toujours - il paraîssait - démodées. Alors, en 1983, le Manitoba a remplacé cette liste par la règle selon laquelle les fiduciaires peuvent investir comme le ferait un investisseur prudent lorsqu'il gère le patrimoine des autres. C'est cette règle qui existe aujourd'hui dans *La loi sur les fiduciaires*.

La difficulté avec cette règle c'est qu'elle s'est avérée beaucoup trop indéfinie et, par conséquent, les tribunaux des juridictions qui appliquent la règle de la personne prudente n'ont pas cessé de raisonner par référence aux listes de placements autorisés. Ces tribunaux ont parlé du capital gardé sans risque et de l'absence de spéculation sur des titres de participation. En période d'inflation élévée; les tribunaux avaient toujours tendance à accorder au bénéficiaire de revenu le taux d'intérêt actuel au lieu du vrai taux de rendement.

Par conséquent, il y a environ quinze ans aux Etats-Unis, les investisseurs professionnels et les avocats ont réclamé une clarification de la signification du terme "prudence" dans un marché contemporain de placement. La théorie moderne du portefeuille ou la règle de l'investisseur prudent, comme elle est nommée, rejette la condition qui existe toujours au Manitoba, que chaque bien ou valeur mobilière acquis doit lui-même satisfaire au teste de prudence comme s'il était le seul bien ou valeur mobilière de la fiducie. La théorie adopte le principe de placement du portefeuille. C'est à dire que la prudence est mesurée en fonction de l'administration du portefeuille dans son ensemble.

Aujourd'hui, il est reconnu que chaque bien comporte un risque, que ce soit une dette ou une action susceptible d'une hausse rapide, et la tâche de chaque investisseur est d'équilibrer le risque parmi tous les placements du portefeuille. Aucun bien n'est exclu automatiquement. A cet égard, l'investisseur s'assure uniquement que le risque d'un bien potentiel ne soit pas trop important en dépit du gain potentiel et que même dans un portefeuille donné, l'acquisition d'un tel bien ne soit pas de la spéculation au lieu du placement.

Pour les fiduciaires, que ce risque soit équilibré est une obligation. En plaçant, les fiduciaires doivent toujours être prudents et sagaces, comme le disent les tribunaux, mais en plus, les fiduciaires doivent dorénavant gérer les placements avec l'esprit tourné vers une idée beaucoup plus complexe. Ils doivent surveiller le marché et ajuster le mélange de biens détenus afin de rendre le fonds fiduciaire le plus efficace possible. En outre, ils doivent suivre ce principe, non seulement pour satisfaire aux conditions actuelles mais également pour satisfaire aux besoins de rendement projettés pendant la durée probable de la fiducie.

DES RÉFORMES DÉJA REALISÉES

Plusieurs états aux Etats-Unis ont déja légiféré la règle de la théorie moderne du portefeuille et les lois sur les fiduciaires de la Nouvelle Ecosse, l'Île Prince Edouard, le Saskatchewan et l'Ontario autorisent à présent, cette même approche de placement. Elle a également été recommandée en Colombie Britannique. Toutes les provinces légiférantes, sauf la Nouvelle Ecosse qui a modifié sa législation plus tôt, ont adopté toutes les, ou au moins la majorité des provisions de la *Loi Uniforme sur les placements par les fiduciaires* adoptée par la Conférence pour l'harmonisation des lois au Canada.

La Commission recommande que, pour la plupart, la même Loi Uniforme soit adoptée au Manitoba. Des recommandations sont faites pour une variation du language du modèle d'acte là où la Commission l'estime appropriée.

UNE PROPOSITION POUR L'ADOPTION DE LA THÉORIE MODERNE DU PORTEFEUILLE AU MANITOBA

En conséquence, la Commission introduirait le principe de la théorie moderne du portefeuille pour remplacer la règle de la personne prudente. La Commission recommande que des critères qui guideraient les fiduciaires quant au choix de leurs placments soient prévus par des règlements pris en vertu de *La Loi sur les fiduciaires* et que pour chaque fiducie - au jour de la prise d'effet de la fiducie ou au jour de l'entrée en vigueur de la réforme proposée - une stratégie de placement soit mise en place par les fiduciaires. Il est également proposé que les fiduciaires soient obligés d'examiner la necessité de diversification de la fiducie en question.

Sous réserve de garanties de nomination et de surveillance, les fiduciaires seraient également permis de déléguer leur fonctions de placement aux experts, y inclus les gestionnaires de fonds mutuel. Pour déterminer si une délégation est appropriée il faut se référer aux circonstances dans lequelles un investisseur prudent déléguerait. Pareillement, comme le ferait un investissuer digne de confiance, les fiduciaires doivent envisager le recours à un expert pour des conseils en placement.

Si le Manitoba adoptait cette approche de placement, une conséquence serait que lorsqu'un tribunal aurait trouvé un fiduciaire coupable au titre des pertes subies par suite de placements effectués, le montant de cette perte pourrait être compensé par les gains correctement générés. La loi présente est muette sur ce point.

D'autres statuts manitobains qui adoptent le pouvoir de placement prévu par *La loi sur les fiduciaires* devraient également être interprêtés comme autorisant le placement selon la théorie moderne du portefeuille.

D'AUTRES RÉFORMES CONNEXES

En outre, la Commission recommande d'adopter plusieurs provisions de portée plus large que celles de la *Loi Uniforme sur les placements par les fiduciaires.*

Lorsque le placement se fait au Manitoba, il est proposé, sous réserve de l'intention contraire du constituant de la fiducie, que *La loi sur les fiduicaires* permette le placement en accord avec la théorie moderne du portefeuille même si la fiducie en question a effet dans deux ou plusieurs juridictions et la loi d'application n'est pas celle du Manitoba. Une telle provision rendrait plus facile la tâche des fiduciaires professionnels gérant plusieurs fiducies.

Le rapport recommande également que les organisations charitables et sans but lucratif, qu'elles soient des fiducies ou des sociétés commerciales, qui sont implantées dans deux ou plusieurs juridictions et qui effectuent des placements au Manitoba, bénéficient des mêmes provisions.

Deux autres recommandations sont soulignées par ce rapport. D'abord, en ce qui concerne les fonds de dotation, que toutes les organisations charitables et sans but lucratif qui font des placements au Manitoba soient autorisées à effectuer des distributions de rendement total ("total return") (c'est à dire, des distributions effectuées au profit des bénéficiaires sans égard à la nature du rendement, que ce soit du revenu ou du capital). Chaque organisation qui souhaite bénéficier des provisions de *La loi sur les fiduciaires* devrait alors determiner, pour la fiducie en question, le pourcentage de rendement qui pourrait être dépensé chaque année ainsi que la fréquence selon laquelle ce pourcentage serait revisé.

La deuxième recommandation est complémentaire à la première. Elle est destinée à assister tous ceux qui souhaitent prévoir un rendement total et donc, des fiducies de pourcentage dans l'acte constitutif de fiducie ou le testament. Ces fiducies sont celles qui prévoient qu'un bénéficiaire de revenu prend plutôt un pourcentage, disant de 5%, des intérêts, dividendes, loyers, royalties et augmentations en valeur de capital qui se réalisent pendant une année donnée. Dans l'alternative, ce pourcentage prédéterminé est dépensé dans l'année sur l'objet ou les objets charitables avancés par le fonds de dotation ou l'organisation charitable ou sans but lucratif enregistrée.

La loi sur les fiduciaires comporterait une section décrivant la nature et l'opération d'une fiducie de pourcentage et le constituant d'une fiducie pourrait adopter cette provision en indicant trois mots - fiducie de pourcentage ("on percentage trusts").

L'AVANT-PROJET DE LOI

La Commission a également inclu un avant-projet de loi intitulé *Loi modifiant la loi sur les fiduciaires.*