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Backgrounder

BCLI Report no. 16—Total Return Investing by Trustees

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A trust is a relationship in which a designated trustee holds title to assets for the benefit of a designated person called the beneficiary. A trust is typically established when an owner of property (called the *settlor*) transfers the property to a trustee on terms describing how the trustee is to administer the property to confer the benefits that the settlor intends. Trustees may invest trust property in order to bring about an increase the value of the trust, or to protect the trust "capital" (the original trust property). "Income" with regard to trusts is made up of revenues earned from the use of trust property and includes rents, stock dividends, and payments made to redeem shares.

When there is only one beneficiary to the trust, all gains flowing from the trust property go to the individual beneficiary. However, the situation is complicated where there are *successive* beneficial interests. This occurs, for example, where one beneficiary has a life interest (the right to benefits that exists over the span of their lifetime), after which the trust capital is transferred by a gift to another beneficiary.

Unless the terms of a trust dictate otherwise, trustees are obliged to administer the trust without favouring one class of beneficiaries over another. This is called the "duty of evenhandedness." Accordingly, trustees must estimate the extent to which a proposed investment will enhance the account of each beneficiary.

Evenhandedness as between classes of beneficiaries in administrating trusts continues to be a valid principle, but it sometimes results in trustees investing inefficiently, in the sense of inability to obtain the maximum overall gain to the trust estate within risk levels dictated by the duty of prudence. This likely gets in the way of the settlor's fundamental intention to confer benefits on an individual, a class of individuals, or a charitable object.

If freed from the requirement to select investments with regard to the legal category of the returns they will bring, trustees would be able to simply maximize the gain to the trust portfolio within risk parameters dictated by the duty of prudence. This method is called "total return" investment. Total return is necessary for trustees to be in the best position to employ the risk/return analysis effectively to obtain the maximum advantage for the trust. If they are constrained by even hand considerations that require estimates of probable "income" or "capital" receipts, trustees cannot make the kind of choices that other prudent investors would make. Investment decision-making needs to be separated from distributional issues. Income tax considerations constrain the use of total return investment under trusts in which private persons are the beneficiaries, but this is not a factor where charitable trusts are concerned. This report recommends amendments to the *Trustee Act* enabling all charitable trusts and foundations to invest on a total return basis and capitalize unspent returns for optimal investment efficiency. It also recommends amendments that would facilitate total return investment under trusts for private beneficiaries where the settlor expressly authorizes it.