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I. Introduction

(a) General

This report contains recommendations by the *Trustee Act* Modernization Committee of the British Columbia Law Institute for changes to the provisions of the *Trustee Act* dealing with investment by trustees. It has been prepared by the Committee as part of the Institute's project on reform of the *Trustee Act*. As this is the first of a series of reports that the Committee will issue as the project progresses, a brief explanation of the *Trustee Act* project and the Committee's objectives and methodology is appropriate.

(b) The Trustee Act Reform Project

One of the projects undertaken by the British Columbia Law Institute after its formation in 1997[1] was an overall reform of the British Columbia *Trustee Act* so as to allow the Act to meet the present-day requirements of trusteeship. While the *Trustee Act* remains an important statute affecting a great variety of legal relationships, many of its provisions are out of keeping with present-day conditions and practices and some provisions are so seriously outdated as to be significant obstacles to efficient trust administration. Other provinces and territories have moved to reform their trustee legislation, but the British Columbia statute remains in need of substantial revision.

(c) The Trustee Act Modernization Committee

The *Trustee Act* Modernization Committee ("the Committee") is one of the Project Committees through which the Institute carries out its program. Its members were appointed by the Board of the Institute to reflect the wills and trusts Bar, the professional fiduciary sector, and academic specialists in trust law.

1. The British Columbia Law Institute was formed in 1997 under the *Society Act* to carry on the work of the former British Columbia Law Reform Commission. Its objectives are to promote the clarification and simplification of the law and its adaptation to modern social needs, to promote improvement of the administration of justice and respect for the rule of law, and to promote and carry out scholarly research.

(d) The Committee's Methodology

The Committee intends to address various aspects of the *Trustee Act* that are in need of reform in a series of short consultative documents and reports. The consultative documents, which will contain proposals for reform and the explanation for them, will be circulated to interested sectors such as the trust and fiduciary industry, the Bar, the Public Trustee's Office, and non-profit foundations to obtain comment on the proposals. They will also be made available to the public upon request. Following this consultation phase, the Committee will finalize its position on the matters addressed by the proposals and present recommendations for legislative change in a series of reports. The reports will receive similar circulation, and will also be sent to the Attorney General.

The ultimate aim of the Committee is to prepare a comprehensive draft of a reformed *Trustee Act* in modern, easily comprehended language. The Statute will contain new provisions required for the legal and financial climate in which trustees now fulfil their duties as well as those elements of the existing Act that must be retained.

II. The Consultation Paper on Trustee Investment Powers and Response

At an early stage, the Committee identified investment powers as the area of the *Trustee Act* that was most urgently in need of reform. In March 1998, it circulated a *Consultation Paper on Trustee Investment Powers* and received comment on the proposals it contained from numerous organizations and individuals. Their names are listed at the end of this report. The Committee gave full consideration to all comments received on the Consultation Paper in formulating the recommendations set out in this report.

An additional issue relating to investment of trust property raised in one response to the Consultation Paper was the difficulty the current law creates for institutions and foundations wishing to invest on a "total return" basis in order to stabilize their annual spending as a percentage of the average value of their endowments over an extended period of time. The Committee recognizes the importance of this issue, but notes that the obstacles to total return investment stem primarily from rules of general trust law characterizing receipts as capital or income in nature and that require trustees to maintain distinctions between the two, rather than from existing statutory investment powers.

Instead of expanding the scope of this report, the Committee plans to address total return investment as a discrete issue at a later stage in this project.[2]

III. What is Wrong With Investment Powers Under the Present *Trustee Act*?

(a) The "Legal List" of Authorized Investments in Section 15 of the Trustee Act

Trustees who are not given express investment powers by a trust instrument must rely on the power given by the *Trustee Act*. Unlike the reformed legislation of some other provinces, British Columbia's *Trustee Act* limits the range of investments that can be made by trustees to the "authorized" list that appears in section 15. The list is heavily weighted towards government and municipal fixed-rate bonds and imposes severe restrictions on investment in equities. Only the shares of Canadian companies qualify, and only if they meet certain tests related to dividends. For those trustees who do not have the flexibility of wide investment powers and are therefore confined to section 15, it is now very difficult to determine whether a particular stock qualifies as an authorized investment or not, and the fact is that most financial institutions have given up trying. Mutual funds, a practical investment vehicle that could be quite useful for trusts of moderate size, are not mentioned in section 15. [3]

Manitoba, New Brunswick, Nova Scotia, and the two territories amended their trustee legislation to abolish the "legal list" at various times in the past and replaced it with a simple requirement for trustees to invest in a prudent manner. No restrictions are placed on the categories of investments that may be selected.[4] The Uniform Law Conference of Canada recommended such a move in 1970. In 1996 the ULCC expanded on its 1970 proposal in the *Uniform Trustee Investment Act 1997*, on which the recent Prince Edward

2. Recent amendments to the legislation under which the Vancouver and Victoria Foundations operate specifically authorize total return investing. See S.B.C. 1998, c. 48, s. 3; S.B.C. 1998, c. 49 ss. 1. Legislation modifying these rules to facilitate investment by charities on a total return basis is under consideration in Manitoba by the Law Reform Commission of that province..

3. The obstacle to investment in mutual funds presented by the rule against delegation by trustees is discussed later in the report.

4. Nova Scotia's legislation provides for restrictions to be imposed by regulation, but none have so far been passed.

legislation is modelled.[5] Ontario[6] and Saskatchewan[7] have very recently passed legislation to repeal the legal list. Their legislation varies in certain respects from the ULCC uniform statute.

British Columbia should also consider reform. Nowadays, trustees face much more fluid investment market conditions than they did forty years ago, when the legal list last underwent comprehensive revision. As a consequence, they require more flexibility in their investment strategies. It is no longer possible to define prudence in investment as placement of the entire fund in fixed-rate bonds, with limited income-generating potential and little scope for capital growth. Some improvement upon the present "legal list" in the British Columbia *Trustee Act* is necessary.

(b) Outdated Registration Requirements

Section 20 of the *Trustee Act* requires that a trustee ensure that all securities belonging to the trust fund are registered in the trustee's name as trustee for the particular trust to which the securities belong. It also requires that all transfers be made on the books of the issuing corporation in the trustee's name. While this section does not apply to trust companies, it can be a major problem for pension fund trustees and those administering larger trust funds with substantial holdings in equities. Section 20 of the *Trustee Act* is simply inconsistent with modern book-based methods of securities trading, which no longer involve the physical movement of share certificates. Modern trading methods depend instead on a fungible mass of interchangeable securities held in a central depository. Some types of securities are not certificated at all. Settlement of trades is done electronically, and a three-day settlement cycle is now standard.

It is impossible to complete trades in this environment if share certificates must be manually processed to change the names on them merely to comply with section 20. In

5. S.P.E.I. 1997, c. 51. We wish to acknowledge out indebtedness to the Uniform Law Conference of Canada, for its work embodied in the *Uniform Trustee Investment Act, 1997* which provided us with an excellent point of departure for further work and thought in relation to this topic.

6. S.O. 1998, c.18, s.16. The Ontario amendment had not been proclaimed in force as of March 1, 1999.

7. S.S. 1998, c. 40, s.3.

addition, as modern securities trading methods make the share registers of public corporations largely meaningless, the requirement for all transfers on the books of the issuer to be completed in the trustee's name is virtually nonsensical. Section 20 is being ignored in practice, although this amounts to a breach of trust.

Repeal of similar requirements has been urged in England, and the Alberta Law Reform Institute recommended amendment of the corresponding Alberta provision in its lengthy study on transfers of investment securities.[8] Trust instruments often contain an express power to allow nominee holdings, in order to bypass this section and enable trustees to invest efficiently under contemporary conditions. Section 20 has definitely outlived its usefulness.

(c) Asset-by-asset Assessment of the Trustee's Performance and the Rule Against Netting Losses Against Gains

(i) Investment selection

Current trust law requires that a determination of whether or not a trustee has acted prudently in investing the trust fund be made on an asset-by-asset approach. In other words, a trustee may be found liable for breach of trust simply because a decision to acquire a particular security for the portfolio results in loss and is considered imprudent. It is not a defence that the trustee may have acted prudently in relation to the overall balance of assets in the portfolio.

(ii) Anti-netting

A related rule of trust law prevents losses from being netted against gains in determining the amount that a trustee in breach may be required to pay to the trust fund if a particular investment decision turns out badly.

8. Alberta Law Reform Institute, *Report on Investment Securities* (1993) at 246-247.

(iii) Uneasy fit with modern portfolio theory

These rules tend to discourage trustees from applying investment strategies that make use of modern portfolio theory, which is based on reduction of overall risk to the portfolio as a whole by acquiring a wide range of investments. Those carrying higher return, and correspondingly greater risk, are balanced in a well-diversified fund by those carrying lower risk. Portfolio theory recognizes the fact that concentration in a few securities means losses in those categories will magnify the proportional loss to the fund. It also recognizes that the probability of loss in a great number of categories at the same time is much smaller than the chance of loss in one category. In other words, modern portfolio theory favours *diversification*.

(d) Restrictions on Delegation

(i) Generally

Current trust law greatly restricts the power to delegate authority with respect to investment. While trustees may carry out actual transactions through agents, such as stockbrokers, without any special powers conferred by a trust instrument, they require an express power in order to delegate authority over:

1. the determination of the "mix," i.e., the ratio of equity to debt securities in the portfolio;
2. the selection of investments; and
3. the timing of purchases and sales.

Trustees must always retain the final responsibility for the investment of the funds for which they are responsible, but it is not always practical for a trustee to specifically select and approve every purchase and sale, or personally execute the documents necessary to transfer the securities. In the case of a trust fund that requires day-to-day investment activity, it is seldom feasible. The current ground rule on delegation of investment authority in trust law places trustees at a disadvantage in relation to other investors by denying them the ability to make effective use of investment managers.

(ii) The Non-Delegation Rule and Investment in Mutual Funds

In some recent Canadian decisions, notably *Re Haslam and Haslam*,[9] the prohibition on delegation of discretionary functions has been applied so as to prevent trusts from investing in mutual funds unless an express power allows it. As the actual securities portfolio underlying the mutual fund units is managed by others, the selection of investments is one step removed from the trustee. Acquisition of mutual fund units is therefore considered to be an improper delegation of authority by the trustee to the mutual fund managers.

Mutual funds are advantageous to most investors because of their high degree of liquidity and the availability of professional management of the underlying portfolio. It is unrealistic to deny trustees the opportunity to obtain these advantages for the benefit of the trust. This is particularly true in the case of trusts of intermediate size, large enough to warrant some equity holdings but not large enough to allow for full diversification.

The *Uniform Trustee Investment Act, 1997* contains a section that would expressly reverse *Haslam*, if enacted. *Haslam* has not yet been applied by a British Columbia court, but the possibility that it would be followed certainly exists. The general law of trusts, of which the non-delegation rule is a part, is the same in British Columbia as the current law in Ontario.

9. (1994) 114 D.L.R. 562 (Ont. Gen. Div.). In *O'Brien Estate* v. *O'Brien*, (20 December 1996) No. 02-77/95 (Ont. Gen. Div.), however, the court did not object to investment of a portion of the estate in mutual funds by trustees who had a power to invest in their sole and uncontrolled discretion. The only objection was to investment in "emerging markets" funds, which was seen as overly speculative. A less rigid view of the rule against delegation is also found in *Re Miller* (1987) 26 E.T.R. 188 (Ont. Surr. Ct.), where the court allowed the cost of investment advice as an expense of the estate, noting that obtaining advice is not a delegation in itself.

IV. Reforms Recommended by the *Trustee Act* Modernization Committee

(a) Replacement of "Legal List" With a General Requirement to Invest As Would a Prudent Investor

The Committee proposes that the "legal list" of authorized investments in section 15 of the *Trustee Act* be repealed and replaced with a provision stating simply that trustees are expected to invest trust property as would a prudent investor. This would remove restrictions on the categories of investments that are open to trustees and allow them to invest in a manner best suited to the requirements of the particular trust for income and capital growth at no more than a reasonable level of risk. The change would bring British Columbia's *Trustee Act* into line with reform of trustee legislation elsewhere in Canada and in the common law world.

Those who responded to the Consultation Paper were predominantly in favour of the abolition of the legal list, though some correspondents favoured restrictions on investment in the case of committeeships, small funds and trusts of minors' property. Some correspondents also expressed concern that financially unsophisticated trustees may be left without guidance if the legal list is repealed.

The Committee considered all of these submissions carefully, but is not persuaded that a statutory list of authorized investment categories provides a satisfactory solution to any of the difficulties faced by the trustee or other fiduciary in the cases suggested by some correspondents as ones in which the range of investments should be limited. The statutory list is equally likely to become a trap for an inexperienced trustee as a guide, since the trustee may not be aware of the legislation and unwittingly depart from the list, thereby committing a breach of trust. It is also undesirable to restrict any trustee or fiduciary to categories of investments that may cease to be safe or productive with change in market conditions. Flexibility to deal with altered circumstances is as important to a trustee of a small fund as a large one.

The same standard of care applies to all trustees, whether the funds they administer are large or small and regardless of the level of financial sophistication of the trustee. It is more appropriate for a trustee seeking general guidance from the Act to be informed of the duty to act as a prudent investor would, rather than be lulled into thinking that

adherence to a list of investment categories will relieve the trustee of all further obligation to ensure a proper rate of return and capital growth, while also guarding against undue risk to the trust capital.

The Committee believes that the general "prudent investor" requirement should apply to all express and implied trusts, subject to any express terms regarding investment of the trust property, or the nature of a particular trust. The nature of some trusts may preclude the imposition of a duty to invest. For example, a trust might be created solely for the purpose of preserving a tangible asset, or might be intended to have such a short duration as to make it impractical to require the trustee to invest the trust property.

The change from a statutory list of authorized investments to a general requirement of prudence in investment without restriction by category of security could take one of three forms.[10] The first would simply contain a statement of the rule, without more. If the authorized list of investments is replaced by a standard of this level of generality, however, is something more required for the guidance of trustees? Should there also be principles set out for establishing an investment strategy and making investment decisions? If so, two further variants are possible. One is to supplement the prudent investor rule with a list of factors that would normally be taken into account in making investments. This approach was taken in the ULCC *Uniform Trustee Investment Act 1997*, which contains optional guidelines derived from those in the American *Uniform Prudent Investor Act*. These are:

(a) general economic conditions;
(b) the possible effect of inflation or deflation;
(c) the expected tax consequences of investment decisions or strategies;

10. In this Report we refer to the recommended provision conferring a power to invest in any form of property or security without restriction by category, subject always to the overriding requirement of prudence, as the "prudent investor rule." In the publications of various law reform bodies, most notably the American Law Institute's *Restatement 3d; Trusts (Prudent Investor Rule)* (1992), the term "prudent investor rule" is used in distinction to "prudent man rule." "Prudent man rule" denotes an earlier approach to the reform of statutory powers of trustees in which legal list regimes like section 15 of the current *B.C. Trustee Act* were replaced with a power to invest in any form of property or security, but which did not involve adoption of modern portfolio theory. The changes recommended by the Committee go beyond the mere abolition of the legal list, and thus beyond the phase of reform of trust law in the U.S. and some Canadian jurisdictions that is often described by reference to a "prudent man" or "prudent person" rule. The Committee's use of the term "prudent investor rule" in this report is consistent in a broad sense with the use of that term in the *Restatement 3d* and other recent legal literature.

(d) the role that each investment or course of action plays within the overall trust portfolio;
(e) the expected total return from income on the appreciation of capital;
(f) other resources of the beneficiary;
(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 third variant would be to make the criteria compulsory. This approach was taken in the amendment recently passed by the Ontario Legislature.[11]

A number of correspondents who commented on the Consultation Paper favoured the inclusion of optional guidelines. None advocated mandatory ones.

Over the course of time guidelines may be seen as a checklist that must be gone through in order for an investment decision to be considered prudent in a legal sense. The standard of "prudence" might thus become equivalent to a mechanical process of demonstrating compliance with the checklist rather than a careful analysis of risk and return in light of prevailing conditions. It is unlikely that less sophisticated trustees would be assisted to any great degree by the inclusion of guidelines such as those listed above, as they will require expert advice in any event in order to assess tax consequences and inflation. More sophisticated trustees will be aware that factors such as those listed in (a) to (h) above play a part in every well-considered investment decision. The Committee does not see guidelines as necessary or desirable, and we do not recommend their inclusion in the legislation.

A question closely related to that of investment guidelines is whether trustees should be under a statutory obligation to establish an investment strategy. Some of our correspondents favoured imposition of such a duty. It may be noted that it is increasingly common for trustees to formulate and record the investment objectives for the funds they administer, partly in an effort to demonstrate that their later decisions are not taken on an

11. See footnote 6.

ill-considered or capricious basis. The Committee nevertheless suspects that a duty to establish an investment strategy would be unenforceable in practice.

A reformed statutory investment power should allow trustees full access to mutual funds, so as to make available the benefits of diversification and professional fund management that this familiar and widely-used investment vehicle can provide. In this regard we have principally in mind the limited ability of small and medium-sized trusts to sustain the transaction costs associated with diversifying a portfolio through direct investment in the equities and bond markets.[12]

Numerous enactments regulating the administration of various funds incorporate section 15 of the *Trustee Act* by reference. These provisions typically state that the fund may be invested in "securities in which trustees are authorized by law to invest."[13] Repeal of the present section 15 will require the legislature to consider whether the restrictions on investment that section 15 currently imposes should continue to be placed on the funds in question. If the enactments giving a power to invest in securities authorized for trustees are simply left to stand, the new statutory powers of investment would probably apply by virtue of section 36(1)(f) of the *Interpretation Act*. Section 36(1)(f) provides that where an enactment is repealed and another is substituted by way of amendment, a reference to the repealed enactment in other provincial legislation is construed as a reference to the new enactment relating to the same subject matter.

The non-statutory rule of interpretation governing references to legislation in deeds and other documents is different, however. A reference in a trust instrument to a legislative

12. These remarks are not made without awareness of the problems of conflict of interest and lack of adequate disclosure in the mutual fund industry identified in the Stromberg Report prepared for the Office of Consumer Affairs of Industry Canada. The requirement of prudence applies equally to investment in mutual funds as to investment in other forms of securities or property. See Stromberg, *Investment Funds in Canada and Consumer Protection* (Industry Canada, Oct. 1998).

13. Some examples are section 27(1) of the *Real Estate Act* R.S.B.C. 1996, c.397, and section 43(3) of the *Islands Trust Act*, R.S.B.C. 1996, c.239. Section 15 of the *Trustee Act* would automatically apply to any trust unless, and to the extent, that it is displaced by an express term or legislative provision. The express incorporation by reference of s. 15 in these examples therefore does little more than simply exclude the implication of any broader power of investment. The more recent tendency in British Columbia legislation establishing public foundations is to state either that section 15 does not apply or that the fund may be placed in securities in which a prudent person might invest. See *Cultural Foundation of British Columbia Act*, R.S.B.C. 1996, c.90, s.8; *Hospital Foundations Act*, R.S.B.C. 1996, c.200, s.32; *Health Research Foundation Act*, R.S.B.C. c.184, s.8.

provision or to the law affecting some act or matter is normally read as a reference to the provision or the general law as it stood at the time the document was executed, in the absence of a contrary intention on the part of the settlor. Thus, questions of interpretation will arise under instruments predating the introduction of the prudent investor rule as to the scope of powers to invest in "securities in which trustees are authorized by law to invest."

These questions emerge in relation to the broader issue of whether the prudent investor rule, and other changes to the statutory powers under the *Trustee Act*, should apply to trusts created before the changes come into force. The Committee believes that the reformed statutory powers should apply to pre-existing trusts, unless they are actually inconsistent with the terms of those trusts. This would be in keeping with the purpose of the *Trustee Act*, namely to supply a basic framework of administrative powers that are not specifically conferred on the trustee by the actual terms of the trust, but which are essential under contemporary conditions.

The Committee recommends:

1. (a) The list of authorized investments in section 15 of the B.C. Trustee Act should be repealed. In its place, there should be a provision imposing a general duty to invest prudently, without reference to a list of categories of investments.

(b) The provision imposing the general duty of prudent investment should apply to all express and implied trusts, subject to the express terms of the trust, unless the nature of a particular trust or the circumstances surrounding its creation are inconsistent with the existence of a duty to invest on the part of the trustee.

(c) The provision imposing the general duty of prudent investment should apply whether the trust came into effect before or after the repeal of the list of authorized investments.

(d) Investment of trust property in mutual funds should be authorized, subject to the general duty of prudence. The provision should state that investment in mutual funds is not a delegation of powers by the trustee.

(e) The legislature should consider whether the new statutory investment powers should apply to fiduciary obligations governed by other legislation incorporating section 15 of the Trustee Act by reference.

(b) Diversification in Modern Portfolio Theory

Trust law should reflect the fact that an assessment of risk versus return is a part of every decision to invest in a security, and that the overall risk to the portfolio can be managed by acquiring a range of securities that are not subject to the same influences on value. Thus, it should recognize that diversification is a prudent strategy under most circumstances.

It does not follow from this that the *Trustee Act* should impose a duty on trustees to diversify the trust portfolio. Many funds are not large enough to permit full diversification and sustain the cost of the advice that would be required to attain it. Trustees of small funds may be constrained to place the fund in a relatively small and liquid range of securities that do not require day-to-day management. Thus, even though the ULCC *Trustee Investment Act, 1997* contains an obligation to diversify that the trustee may show is inappropriate in the case of a particular trust, the Committee opposes the imposition by the *Trustee Act* of a positive duty to diversify. No support for such a duty was found in the comments received by the Committee on the Consultation Paper.

A change that the Committee does see as necessary, however, is for the standard of "prudence" to be applied to investment decisions on a portfolio-wide basis rather than on an investment-by-investment basis, as general trust law now stipulates when those decisions are called into question. The overall prudence of a trustee's investment strategy is not necessarily compromised by losses on a few individual securities if acquisition of those securities was appropriate in the context of diversification. The Committee therefore recommends that trustees should not be liable for losses occurring in relation to particular investments, if a prudent investor could have made those investments in the context of a generally prudent investment strategy.

Closely associated with the feature of current trust law requiring investment-by-investment consideration of the propriety of a trustee's investment decisions is the rule that prevents losses from being off-set by gains in determining the amount for which a trustee

is liable for investing in a manner producing loss to the trust. This rule may be argued to be unnecessarily harsh. It permits more than 100% recovery, and fails to take account of the uncertainty inherent in all investment decisions. Retention of this "anti-netting" rule would sit uneasily with the concept of portfolio-wide assessment of investment performance.

The opposite view is that to abolish the anti-netting rule would be to remove a deterrent against carelessness in investing trust property, and allow delinquent trustees to benefit from their own imprudence.

In the Consultation Paper the Committee raised the question whether the anti-netting rule should be abolished. The correspondents who addressed this question all favoured abandonment of the rule, some emphasizing that the assessment of investment performance on a portfolio-wide basis made the rule virtually redundant in any case. The Committee agrees that the scope for operation of the anti-netting rule will be greatly reduced if portfolio-wide assessment is mandated by the Act. The Committee still sees some value in retaining a deterrent, however, and favours retention in cases where an investment loss is associated with a breach of trust involving dishonesty. The rule should not apply where an investment loss is attributable solely to bad judgment in investment matters.

Accordingly, the Committee recommends:

2. (a) The rule of general trust law that requires decisions of trustees to be assessed on an investment-by-investment basis when they are called into question should be abrogated. The Trustee Act should be amended to provide that the trustee's performance should be assessed on a portfolio-wide basis, with the test being whether the overall investment strategy was prudent for the circumstances of the trust.

(b) The rule of general trust law that prohibits losses from being off-set by gains in the assessment of damages for breach of trust should not be applied where the breach arises solely from imprudence in investment of the trust property, not associated with dishonesty on the part of the trustee.

(c) Delegation of Authority in Investment Matters

The Committee observes that delegation is taking place as a practical necessity in trust administration and that it no longer makes sense to prohibit it. Even within financial institutions, delegation may arise from the fact that the investment arm may be in a corporate organization separate from the branches handling other aspects of trust administration. While responses to the Consultation Paper were by no means uniform as to the degree of delegation that should be possible in investment matters, the Committee considers that broader statutory powers of delegation are required in investment as well as in other aspects of trusteeship. Trustees should have access to professional fund management as other prudent investors do. If trustees who delegate authority exercise prudence in selecting the agent to carry out an investment-related task, delineate clearly the scope of the authority to be delegated, and supervise the agent in a reasonable manner, as they are now required to do by general trust law, it should not matter that the authority that is delegated contains some element of discretion. The discretion might extend, for example, to selection of investments and the making of decisions with respect to the timing of acquisitions and dispositions on a day-to-day basis. This does not mean that the trustee should be relieved of final responsibility for properly supervising the agent's exercise of limited discretionary power.

The Committee recommends:

3. Trustees should be permitted to delegate authority in relation to investment of trust property to the degree to which delegation under the circumstances is in keeping with ordinary prudent investment practice. This should be true even if the delegation involves some element of discretion. Trustees who delegate authority should be required to determine the investment objectives for the particular trust in question, exercise prudence in selecting the agent, acquaint the agent with the investment objectives, determine the appropriate limits of the authority delegated, and supervise the agent's performance.

(d) Common Trust Fund of a Trust Company

(i) Generally

In British Columbia, trust companies are now authorized to pool trust assets for investment purposes if the trusts attaching to those assets do not prohibit it.[14] Pooling into a common trust fund in this manner allows for more efficient investment of smaller trusts. In particular, brokerage commissions and other expenses associated with securities transactions are spread over all the participating trusts, rather than being borne by them individually. Greater diversification can be attained at a lower cost to each trust than if the funds were invested separately. Greater stability in portfolio value and greater regularity of income may be achieved than is usually possible with individual small portfolios. Pooling in this manner thus provides some of the same advantages as mutual funds, but also the additional advantage that full information is available regarding all portfolio transactions. In addition, management fees are not charged in respect of the values of units in the common trust fund. The trust estate is charged only the trust company's regular fee for fiduciary services.

(ii) Common Trust Fund Units as Trust Investments

As the law presently stands, the deposit of trust property with a trust company that is not one of the trustees, with the intention being to place the deposited property in the trust company's common trust fund, would most probably be an impermissible delegation of the trustee's investment powers. The Committee nevertheless believes that it would be useful for trustees to have the power to invest trust property in a common trust fund operated by a trust company for the reasons mentioned in subsection *(i)* above.

(iii) Trust Company as Co-Trustee

It is fairly common for a trust company to be appointed a co-trustee together with a relative of the settlor or testator. The present law likely prevents trust funds administered in this manner from being placed in a common trust fund operated by the corporate co-

14. *Financial Institutions Act*, R.S.B.C. 1996, c. 141, s. 72.

trustee, as this would also be treated as a delegation by the individual co-trustee.[15] The Committee believes that investment through the common trust fund should be allowed in this situation also. The efficiencies that may be derived outweigh the theoretical objections that might be mounted on the basis of the anti-delegation rule.

The Committee accordingly recommends:

4. (a) Individual trustees should be permitted to place trust funds for investment in a common trust fund managed by a trust company.

(b) Investment in a common trust fund administered by a corporate co-trustee should also be permissible.

(e) Provision for Investment Through Normal Investment Market Procedures: Repeal of Section 20 of the Trustee Act

In order to invest effectively, trustees should be able to make use of standard investment market procedures. One of these is to invest through a trading account with a securities firm. Section 20 of the *Trustee Act*, which requires all securities held by a trust to be in the trustee's name, should be repealed and replaced by a provision allowing trust securities to be held in the name of a securities depository or a nominee, as long as it is possible to determine what securities a trust holds at any given time.

The Committee received no response urging the retention of section 20 and several that supported its repeal. We also observe that section 14 of the *Public Guardian and Trustee Act* of British Columbia,[16] a recent enactment not yet brought into force, permits investments made by the Public Guardian and Trustee to be made in the name of a bank or a trust company or their nominees despite section 20 of the *Trustee Act*, as long it is apparent that the Public Guardian and Trustee is the beneficial owner. Section 14 also permits investments of the Public Guardian and Trustee to be maintained in a book-based

15. See *Central Guaranty Trust Co.* v. *Sin-Sara* (1995), 24 O.R. (3d) 820 (Gen. Div.).

16. R.S.B.C. 1996 (Supp), c.383.

system by a securities depository. This recent enactment reinforces the view that section 20 of the *Trustee Act* is badly outdated.

The Committee recommends:

5. Section 20 of the Trustee Act, which requires all trust securities capable of registration to be registered in the trustee's name as trustee for the particular trust, should be repealed to allow investment of trust property to be carried out through contemporary exchange trading methods, subject to a requirement that the holdings of the trust be identifiable at any given time.

(f) Ethical and Philosophical Criteria for Investment Selection

An issue that has arisen relatively recently concerns the application of what have been referred to as "ethical investment" policies by trustees. Ethical investment policies involve the use of moral, philosophical, and religious criteria for investment selection, rather than exclusively economic factors. Various mutual fund issuers now advertise "ethical investment funds", which exclude from their portfolios securities linked to particular companies or industries whose activities are perceived to run counter to these non-economic criteria. Manitoba's *Trustee Act* was recently amended to state that the use of non-financial criteria in setting an investment policy or making investment decisions does not amount to a breach of trust in itself.[17]

As the law now stands in British Columbia, trustees are likely in breach of trust if they apply non-economic criteria in selecting investments, such as a policy of boycotting certain industries or securities of certain governments, and thereby obtain a lower level of return than would be the case if only economic considerations were used.[18]

An assumption that investment policies reflecting a particular philosophical standpoint invariably bring about lower returns would be unjustified. But whether trustees should be

17. C.C.M., c. T160, s. 79.1, as enacted by S.M. 1995, c. 14, s.3.

18. See *Cowan* v. *Scargill*, [1985] Ch. 270.

free to subordinate the financial well-being of the trust to ethical or philosophical concerns of their own or of others, even those of beneficiaries, is a troublesome question.

It may be difficult to determine a consensus among the beneficiaries of a large trust, such as one relating to a pension fund. The doubt that would surround an attempt to gauge attitudes among a large group of beneficiaries highlights the tenuous basis for allowing trustees to depart from economic criteria.[19]

As the achievement of any indirect aims through a trust depends largely on that trust being able to serve its immediate financial purposes, legislation putting non-financial criteria for investment on the same level as financial ones would not be likely to send the correct message to those administering trusts. Our view, therefore, is that the *Trustee Act* should not authorize trustees to give weight to non-financial criteria for investment. Instead, the power should have to come from the trust instrument.

The Committee recommends:

6. There should be no change in the law regarding the application of non-financial criteria (e.g. ethical and philosophical criteria) for investment selection by trustees. Application of non-financial criteria must be authorized by the terms of the trust if the trustees are to be excused from liability for obtaining a lower return than conventional financial investment criteria would produce.

V. Conclusion

The *Trustee Act* Modernization Committee believes the changes it recommends in this Report will provide trustees with adequate statutory powers to invest trust property

19. An Ontario statute passed during the apartheid era, the *South African Investments Act*, R.S.O. 1990 c. S. 16, imposed a requirement to test the views of beneficiaries of a trust having fewer than 100 beneficiaries before the trustees could make use of a provision that relieved them of liability for breach of trust if they refused to acquire potentially profitable South African investments or disposed of them. If there were more than 100 beneficiaries, the trustees had to have reasonable grounds to believe that a majority in interest of the beneficiaries did not oppose such moves.

efficiently and productively under contemporary circumstances. We urge their rapid enactment. A point of departure for legislative drafters is the ULCC *Uniform Trustee Investment Act 1997*, which has already been followed or adapted in four provinces.

The Committee expresses its thanks to those individuals and organizations who commented on the proposals in the *Consultation Paper on Trustee Investment Powers*. The Committee has drawn great assistance from their participation in this law reform project.

VI. Summary of Recommendations

1. (a) The list of authorized investments in section 15 of the B.C. Trustee Act should be repealed. In its place, there should be a provision imposing a general duty to invest prudently, without reference to a list of categories of investments.

(b) The provision imposing the general duty of prudent investment should apply to all express and implied trusts, subject to the express terms of the trust, unless the nature of a particular trust or the circumstances surrounding its creation are inconsistent with the existence of a duty to invest on the part of the trustee.

(c) The provision imposing the general duty of prudent investment should apply whether the trust came into effect before or after the repeal of the list of authorized investments.

(d) Investment of trust property in mutual funds should be authorized, subject to the general duty of prudence. The provision should state that investment in mutual funds is not a delegation of powers by the trustee.

(e) The legislature should consider whether the new statutory investment powers should apply to fiduciary obligations governed by other legislation incorporating section 15 of the Trustee Act by reference.

2. (a) The rule of general trust law that requires decisions of trustees to be assessed on an investment-by-investment basis when they are called into question should be abrogated. The Trustee Act should be amended to provide that the trustee's performance should be assessed on a portfolio-wide basis, with the test being whether the overall investment strategy was prudent for the circumstances of the trust.

(b) The rule of general trust law that prohibits losses from being off-set by gains in the assessment of damages for breach of trust should not be applied where the breach arises solely from imprudence in investment of the trust property, not associated with dishonestly on the part of the trustee.

3. Trustees should be permitted to delegate authority in relation to investment of trust property to the degree to which delegation under the circumstances is in keeping with ordinary prudent investment practice. This should be true even if the delegation involves some element of discretion. Trustees who delegate authority should be required to determine the investment objectives for the particular trust in question, exercise prudence in selecting the agent, acquaint the agent with the investment objectives, determine the appropriate limits of the authority delegated, and supervise the agent's performance.

4. (a) Individual trustees should be permitted to place trust funds for investment in a common trust fund managed by a trust company.

(b) Investment in a common trust fund administered by a corporate co-trustee should also be permissible.

5. Section 20 of the Trustee Act, which requires all trust securities capable of registration to be registered in the trustee's name as trustee for the particular trust, should be repealed to allow investment of trust property to be carried out through contemporary exchange trading methods, subject to a requirement that the holdings of the trust be identifiable at any given time.

6. There should be no change in the law regarding the application of non-financial criteria (e.g. ethical and philosophical criteria) for investment

selection by trustees. Application of non-financial criteria must be authorized by the terms of the trust if the trustees are to be excused from liability for obtaining a lower return than conventional financial investment criteria would produce.

List of Individuals and Organizations Commenting on the Consultation Paper

William L. Andrew
Aon Consulting Inc.
Canada Trust
Canadian Bankers Association Fiduciary Committee
Canadian Bar Association
- Wills and Trusts Subsection (Okanagan)
- Wills and Trusts Subsection (Vancouver) Review Subcommittee

Connor Clark & Lunn Investment Management Ltd.
Council of Chief Executive Officers of the Advanced Education Council of B.C.
P. Kennedy
Leith Wheeler Investment Council Ltd.
McCarthy Tetrault
- P. Beckmann
- N. Brox

Montreal Trust Company
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M. Payne
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University of British Columbia Treasury Department (B. Braley)
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Membership of *Trustee Act* Modernization Committee

The members of the *Trustee Act* Modernization Committee are:

Professor D.W.M. Waters, Q.C. - Chair
Kathleen Cunningham
Margaret Mason
Professor J.M. MacIntyre, Q.C.
Arthur L. Close, Q.C. - Executive Director, BCLI
Greg Blue - Reporter

Appendix

Trustee Act
R.S.B.C. 1996, Chapter 464

Selected provisions

Section 15 — Trustee authorized investments

15 A trustee may invest trust money in his or her hands, if the investment is in all other respects reasonable and proper, in

(a) securities of Canada, a province, the United Kingdom, the United States of America or a municipal corporation in a province,

(b) securities the payment of the principal and interest of which is guaranteed by Canada, a province, the United Kingdom, the United States of America or a municipal corporation in a province,

(c) securities issued for school, hospital, irrigation, drainage or other similar purposes that are secured by or payable out of rates or taxes levied under the law of a province on property in that province,

(d) bonds, debentures or other evidence of indebtedness of a corporation that are secured by the assignment to a trustee of payments that Canada or a province has agreed to make, if those payments are sufficient to meet the interest on all the bonds, debentures or other evidence of indebtedness outstanding as it falls due and also to meet the principal amount of all the bonds, debentures or other evidence of indebtedness on maturity,

(e) bonds, debentures or other evidence of indebtedness of a corporation incorporated under the laws of Canada or a province that are fully secured by a mortgage, charge or hypothec to a trustee on any one or combination of the following assets:

(i) land;

(ii) the plant or equipment of a corporation that is used in the transaction of its business;

(iii) bonds, debentures or other evidence of indebtedness or shares of a class or classes authorized by this section,

(f) bonds, debentures or other evidence of indebtedness of a corporation incorporated under the laws of Canada or a province if the corporation has earned and paid a dividend,

(i) in each of the 5 years immediately preceding the date of investment, at least equal to the specified annual rate on all of its preferred shares, or

(ii) in each year of a period of 5 years ending less than one year before the date of investment, on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,

(g) guaranteed trust or investment certificates of
  (i) a bank, or
  (ii) a corporation that is incorporated under the laws of Canada or of a province and that has a business authorization to carry on trust business or deposit business,

(h) bonds, debentures or other evidence of indebtedness of a loan corporation or similar corporation
  (i) that at the time of investment has all of the following:
    (A) power to lend money on mortgages, charges or hypothecs of real estate;
    (B) a paid up nonreturnable capital stock of not less than $500 000;
    (C) a reserve fund amounting to not less than 25% of its paid up capital, and
  (ii) the stock of which has a market value that is not less than 7% in excess of its par value,

(i) preferred shares of a corporation incorporated under the laws of Canada or of a province if the corporation has paid a dividend,
  (i) in each of the 5 years immediately preceding the date of investment, at least equal to the specified annual rate on all of its preferred shares, or
  (ii) in each year of a period of 5 years ending less than one year before the date of investment, on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid,

(j) first mortgages, charges or hypothecs on land in Canada, but only if the loan does not exceed 75% of the value of the property at the time of the loan as established by a valuator whom the trustee believes on reasonable grounds to be competent and independent,

(k) securities issued or guaranteed by the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development, approved by the Bretton Woods and Related Agreements Act (Canada), but only if the bonds, debentures or other securities are payable in the currency of Canada, the United Kingdom, a member of the British Commonwealth or the United States of America,

(l) fully paid common shares of a corporation incorporated under the laws of Canada or of a province that, in each year of a period of 7 years ending less than one year before the date of investment, has paid a dividend on its common shares of at least 4% of the average value at which the shares were carried in the capital stock account of the corporation during the year in which the dividend was paid, and

(m) deposits in, or non-equity or membership shares or other evidence of indebtedness of, a credit union.

Section 16 — National Housing Act mortgages

16 Despite section 15 (j), a trustee investing trust money in a first mortgage security on land in Canada, if the mortgage is an insured loan under the National Housing Act (Canada), is not chargeable with breach of trust merely because the amount of the loan exceeds 75% of the value of the property mortgaged.

Section 17 — Investment rules

17 (1) In determining market values, a trustee may rely on published market quotations.

(2) A corporation that is a trustee must not invest trust money in its own securities.

(3) In the case of an investment under section 15 (e), the inclusion, as additional security under the mortgages, charges or hypothecs, of other assets not of a class authorized by this Act as investments does not render the bonds, debentures or other evidence of indebtedness ineligible as an investment.

(4) No investment may be made under section 15 (e), (f), (h), (i) or (l) that would at the time of making the investment cause the aggregate market value of the investments made under those paragraphs to exceed 35% of the market value at that time of the whole trust estate.

(5) For the purpose of subsection (4), investments made by the testator or settlor and retained by the trustee under the authority of the trust instrument and that come within any of the classes authorized by section 15 (e), (f), (h), (i) or (l) are deemed to have been made by the trustee.

(6) No sale or other liquidation of any investment made under section 15 (e), (f), (h), (i) or (l) is required merely because of a change in the ratio between the market value of that investment and the market value of the whole trust estate.

(7) In case of investment under section 15 (i) or (l), not more than 30% of the total issue of shares of any corporation may be purchased for any trust.

(8) No investment may be made under section 15 (i) or (l) unless the shares are listed at the time of investment on a recognized stock exchange.

Section 18 — Additional investments

18 In addition to the investments authorized by section 15 or by the trust instrument, except if that instrument expressly prohibits the investment, a trustee may invest funds in the other securities the court on application in a particular case approves as fit and proper, but nothing in this section relieves the trustee of his or her duty to take reasonable and proper care with respect to investments so authorized.

Section 19 — Depositories

19 A trustee may, pending the investment of trust money, deposit it during a time that is reasonable in the circumstances in

(a) a bank, or

(b) a corporation that has a business authorization to carry on deposit business.

Section 20 — Investments in trustee's name

20 (1) Except in the case of a security that cannot be registered, a trustee who invests in securities must require them to be registered in his or her name as the trustee for the particular trust for which the securities are held, and the securities may be transferred only on the books of the corporation in his or her name as trustee for the trust estate.

(2) This section does not apply to a corporation that has a business authorization to carry on trust business.

Section 21 — Instrument creating the trust

21 (1) The powers conferred by this Act relating to trustee investments are in addition to the powers conferred by any instrument creating the trust.

(2) Nothing in this Act relating to trustee investments authorizes a trustee to do anything the trustee is in express terms forbidden to do or to omit to do anything the trustee is in express terms directed to do by the instrument creating the trust.

Section 22 — Variation of trustee investments

22 (1) A trustee in his or her discretion may

(a) call in trust funds invested in securities other than those authorized by this Act and invest them in securities authorized by this Act, and

(b) vary any investments authorized by this Act.

(2) A trustee is not liable for a breach of trust merely because the trustee continues to hold an investment that since its acquisition by the trustee has ceased to be one authorized by the instrument of trust or by this Act.

(3) If a trustee has improperly advanced trust money on a mortgage that would at the time of the investment have been a proper investment in all respects for a less sum than was actually advanced, the security is deemed to be an authorized investment for the smaller sum, and the trustee is only liable to make good the excess amount advanced, with interest.