

Fiduciaries Facing Downturn in the Market Should Take Steps to Ensure Compliance with the Prudent Investor Act

Trustees face added risk of litigation during times of economic trouble. After the dot-com bubble burst in 2001, and mortgage defaults led to crisis in 2008, trust beneficiaries and others pointed their fingers at individual fiduciaries and professional money managers, commencing lawsuits with the hope of recovering their losses. As the longest bull market in history comes to an end, compounded by the slowdown of the world economy in the hopes of curtailing the COVID-19 pandemic, fiduciaries can expect a new wave of litigation.

Fiduciaries are shielded from personal liability for investment decisions so long as they act within the bounds of the Prudent Investor Act (Act) that defines the standard by which investment decisions are judged.

The prudent investor standard proscribes certain conduct and is not a guarantee of any particular outcome. Compliance with the standard is determined in light of the facts and circumstances at the time of a decision or action. The standard requires trustees to exercise reasonable care, skill and caution to make and implement investment decisions.

Among the specific requirements of the Act are:

- Pursuit of an overall investment strategy to enable appropriate present and future distributions to or for the benefit of the beneficiaries, in accordance with risk and return objectives reasonably suited to the entire portfolio;
- Considerations, when relevant, include:
 - the size of the portfolio,
 - the nature and estimated duration of the fiduciary relationship,
 - the liquidity and distribution requirements of the governing instrument,
 - general economic conditions,
 - the possible effect of inflation or deflation,
 - the expected tax consequences of investment decisions or strategies and of distributions of income and principal,
 - the role that each investment or course of action plays within the overall portfolio,
 - the expected total return of the portfolio (including both income and appreciation of capital), and
 - the needs of beneficiaries (to the extent reasonably known to the trustee) for present and future distributions authorized or required by the governing instrument;
- Diversification of assets unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument; and
- Determination, within a reasonable time after the creation of the fiduciary relationship, whether to retain or dispose of initial assets.

Not all trustees are sophisticated investors, and the Act allows trustees to delegate investment and management functions when doing so is consistent with the duty to exercise skill, including special investment skills. In that case, the conduct of the Trustee is measured by the care and due diligence in selecting the investment advisor and monitoring the advisor's performance. Trustees may use trust assets, when appropriate, to pay for necessary advice.

Litigation over the prudent investor standard arises when trustees make unreasonable decisions, fail to diversify or intentionally concentrate investments, make unsuitable investments, fail to change investments considering changing conditions, or favor one class of beneficiaries (either lifetime or residuary) over the other class. As market conditions change, trustees should be consulting with their investment advisors, tax advisors and legal counsel to ensure that appropriate steps are being taken.

In addition to making appropriate decisions, trustees should retain documents reflecting their decisions and the factors considered when making those decisions. Trustees should also retain all bank and investment account statements for trust accounts and receipts and other evidence documenting the expenditure of trust funds and the purpose of such expenditures. These documents will be critical when defending litigation alleging violation of the Act. The failure to retain sufficient documentation may result in the imposition of a negative inference in litigation, allowing the court to assume that any losses in investment accounts were the result of mismanagement.

For more information on compliance with the Prudent Investor Act, to explore potential claims against a trustee or obtain assistance defending against claims by beneficiaries, please contact Trust & Estates practice group chair, [Edward C. Radin](#), [Brian Laudadio](#), [Curtis A. Johnson](#), any of the [attorneys](#) in our [Trust and Estate Practice](#), or the attorney in the firm with whom you are regularly in contact.



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