

SENATE MANAGEMENT, INVESTMENT AND FINANCIAL
INSTITUTIONS COMMITTEE

STATEMENT TO

SENATE, No. 1092

with committee amendments

STATE OF NEW JERSEY

DATED: JUNE 6, 1996

The Senate Management, Investment and Financial Institutions Committee reports favorably and with committee amendments, Senate Bill No. 1092.

This bill, as amended, repeals existing law, N.J.S.3B:20-12 through 17, commonly known as the "prudent man rule" and, in its place, establishes a new prudent investor rule for fiduciaries in New Jersey. The bill incorporates many of the provisions of the Uniform Prudent Investor Act recently adopted by the National Conference of Commissioners on Uniform State Laws which, in turn, drew upon the revised standards for prudent trust investment stated in the Restatement (Third) of Trusts: Prudent Investor Rule (1992).

Fiduciaries must follow the investment standard set forth in their governing instrument, such as a will, deed, agreement or court order pursuant to which money or other property is entrusted to a fiduciary. If no standards are specified, the bill requires that the fiduciary comply with the new prudent investor rule. The bill's definition of "fiduciary" includes executors, trustees, guardians, conservators and "every other individual or corporation charged with the duty of administering a trust estate."

The bill changes substantially the criteria for prudent investing by fiduciaries. The bill requires a fiduciary to invest trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust, requires the fiduciary to exercise reasonable care, skill and caution and imposes upon the fiduciary the duties of loyalty and impartiality toward beneficiaries. The bill incorporates the "modern portfolio theory," by specifying that a fiduciary's investment and management decisions respecting individual assets are not to be evaluated in isolation, but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust. In the context of this "modern portfolio theory," no specific investment or course of action is per se imprudent, so long as each investment or course of action is consistent with an

overall investment strategy as required under the standard of care set forth in the bill. Specific circumstances that a fiduciary should consider in investing and managing trust assets are set forth in the bill, but the list is not intended to be exclusive. The fiduciary is required to take reasonable steps to verify facts relevant to the investment and management of trust assets and is protected in relying on certain information contained in or offered by any financial, statistical, investment, rating or other publication or other service published for the use of and accepted as reliable by investors in like investments or upon a copy of the prospectus prepared and filed with the Securities and Exchange Commission in connection with a new issue.

The bill requires a fiduciary to diversify the investments of the trust unless it is reasonably determined that, because of special circumstances, the purposes of the trust are better served without diversification.

The new prudent investor rule imposes a standard of conduct, not of performance or outcome. Compliance by a fiduciary is determined in light of the facts and circumstances existing at the time of the fiduciary's decision or action.

The second major revision to current law made by the bill concerns delegation of investment responsibility. The bill allows a fiduciary to delegate investment and management functions that a prudent fiduciary of comparable skills could properly delegate under the circumstances.

A fiduciary that exercises reasonable care, skill and caution in selecting an investment agent, establishing the scope and terms of the delegated function, and periodically monitoring the agent's performance and compliance with the scope and terms of the delegation shall not be liable to the beneficiaries or to the trust for the agent's decisions or actions. The agent to whom a fiduciary has delegated investment responsibility owes to the trustee and to the beneficiaries the same duties as the fiduciary and shall be held to the same standards as the fiduciary. The bill makes the agent subject to the jurisdiction of the courts of New Jersey, even if the agent delegation agreement provides otherwise. The bill requires the fiduciary to give the income beneficiaries advance notice of any intended delegation.

In investing and managing trust assets, the bill requires that a fiduciary incur only those costs that are appropriate and reasonable in relation to the assets, the trust purposes and the skills of the fiduciary. To protect the beneficiaries, where the fiduciary has delegated investment responsibility the bill requires a reduction in the fiduciary's compensation to reflect the fiduciary's lessened responsibilities.

The bill also amends section 38 of P.L.1948, c.67 (C.17:9A-38) to make the new prudent investor rule applicable to the investments of common trust funds maintained by New Jersey banks.

The bill provides that the Director of the Division of Investment shall not be subject to the fiduciary standards of the new "Prudent Investor Act," and keeps the director subject to fiduciary standards

identical to the standards of the current "Prudent Investment Law" (N.J.S.A.3B:20-12 et seq.) when the director invests and manages funds in the custody of the State Treasurer.

Finally, the bill makes the provisions of the "Prudent Investment Act" applicable to trusts existing on and created after its effective date.

Amendments to the bill require a fiduciary to review the trust assets and make and implement decisions concerning the retention and disposition of assets received at the inception of the trust within six months after accepting trust assets; delete the 1837 Surplus Revenue Fund from, and add the Judicial Retirement System of New Jersey and all other funds in the custody of the State Treasurer, unless otherwise provided by law, to the list of funds for which the Director of the Division of Investment has the authority to invest and reinvest the moneys in, and to acquire for or on behalf of, such investments which are authorized or approved for investment by regulation of the State Investment Council; and remove a duplicate definition of investments as this definition relates to the functions of the Director of the Division of Investments.