Trust Management and Investment

The Texas Trust Code Prudent Investor Standard

Originally, the standard imposed on a trustee for investing trust assets was referred to as the “prudent man" rule, later referred to as the "prudent person" rule.

This rule provided that unless altered by the terms of the trust agreement: *"in acquiring, investing, reinvesting, exchanging, retaining, selling, supervising, and managing trust property, . . . a trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probably increase in value and the safety of their capital".*

When this rule was in effect it applied on an asset-by-asset basis (not to the trust portfolio as a whole), thus causing issues for trustees who might be held liable if *one* investment out of a portfolio of a hundred investments failed to meet the test.

Later on the prudent investor rule was modified to provide that *"in determining whether a trustee has exercised prudence with respect to an investment decision, such determination shall be made taking into consideration the investment of all the assets of the trust, . . . over which the trustee had management and control, rather than a consideration as to the prudence of the single investment of the trust."* This was an attempt to incorporate modern portfolio theory (“MPT”) into Texas trust law. MPT recognizes that it is appropriate for certain portfolios to include some higher risk investments that theoretically will greater opportunity for higher returns.

Under common law established by court cases and judicial reasoning the general standard of the prudent investor rule at that time it was in effect in Texas was to establish that the trustee was under a duty to the beneficiaries to invest and manage the assets of a trust as a prudent investor would when exercising reasonable care, skill, and caution, as applied to investments not in isolation but in the context of the total portfolio as a part of an overall investment strategy, incorporating risk and return objectives reasonably suitable to the trust.

Current Texas trust statutes are based on the Uniform Prudent Investor Act and that a trustee manages a trust portfolio based on the prudent investor standard and discussed in general as noted above.

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