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Section Title: Introductions & Adoptions Of Uniform Acts.

> A Few Facts About The...

UNIFORM PRINCIPAL AND INCOME ACT

PURPOSE:
This act revises the Uniform Principal and Income Act of 1931 and 1962, which has been adopted in 41 states. The purpose of the new act, like its predecessors, is to provide procedures for trustees administering an estate in separating principal from income, and to ensure that the intention of the trust creator is the guiding principle for trustees. A revision is necessary so that principal and income allocation rules can function with modern trust investment practices.

ORIGIN:
Completed by the Uniform Law Commissioners in 1997.

APPROVED BY:
American Bar Association

STATE ADOPTIONS:
Alabama
Arizona
Arkansas
California
Colorado
Connecticut
District of Columbia
Florida
Hawaii
Idaho
Indiana
Iowa
Kansas
Maine
Maryland
Missouri
Nebraska
New Jersey
New Mexico
New York
North Dakota
Ohio *
Oklahoma
Pennsylvania
South Carolina
Tennessee
Virginia
Washington
West Virginia
Wyoming

** 2003 Enactment*

2003 INTRODUCTIONS:
Montana
Ohio
Oregon

For any further information regarding the Uniform Principal and Income Act (1997), please contact Michelle Clayton, John McCabe or Katie Robinson at 312-915-0195.

SITE MAP
211 E. Ontario Street, Suite 1300
Chicago, Illinois 60611

EXHIBIT C Senate Committee on Judiciary
Date: 3/3/03 Page 1 of 8

UNIFORM PRINCIPAL AND INCOME ACT (1997)

The Uniform Principal and Income Act, originally promulgated by the Uniform Law Commissioners in 1931, revised in 1962, and adopted in 41 states, provides procedures for trustees administering an estate in separating principal from income. The basic purpose of the new act, like the 1931 and 1962 versions, is to ensure that the intention of the trust creator is the guiding principle for trustees. Like its predecessors, this revision distinguishes between property that is principal, which will be distributed to remainder beneficiaries (persons entitled to receive principal when an income interest ends), and property that is income, distributed to income beneficiaries.

The Uniform Act has always provided the default rules for such allocations in the event the trust investment is silent.

There are many reasons why every state should adopt the Revised Uniform Principal and Income Act (1997).

- The law of trust investment has been modernized. It is now time to update the traditional income and allocation rules so that it can work with the doctrine of modern investment theory.
- The new act provides a means for implementing the transition to an investment regime based on principles embodied in the Uniform Prudent Investor Act, especially the principle for investing for total return instead of for a certain level of income.
- The new act better clarifies allocations of acquired assets, such as those from corporate distributions.
- An "unincorporated entity" concept has been introduced to deal with businesses operated by a trustee, including farming and livestock operations, and investment activities in rental real estate, natural resources, and timber.
- The new act provides for investment modalities that were not in existence in 1962, such as derivatives, options, deferred payment obligations, and synthetic financial assets.
- There is a new provision which deals with the problem of disbursements made because of environmental laws.
- New provisions which deal with the imbalances as a result of tax laws are also included. The act provides the power to make adjustments between principal and income to correct inequities caused by tax elections or peculiarities in the way the fiduciary income tax rules apply.

UNIFORMITY

This act will provide uniformity of law, necessary in an interstate investment environment. The Revised Uniform Principal and Income Act provides answers to long-standing problems in reconciling modern portfolio management with traditional rules of income allocation. It is important that every state adopt this act as soon as possible.

Diver
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U L
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Uniform Law Commissioners

The National Conference of Commissioners on Uniform State Laws

Section Title: Introductions & Adoptions Of Uniform Acts.

> A Few Facts About The...

UNIFORM PRUDENT INVESTOR ACT

PURPOSE:
This act removes much of the common law restriction upon the investment authority of trustees of trusts and like fiduciaries. It allows such fiduciaries to utilize modern portfolio theory to guide investment decisions. A fiduciary's performance is measured on the performance of the whole portfolio, not upon the performance of each investment singly. The act allows the fiduciary to delegate investment decisions to qualified and supervised agents. It requires sophisticated risk-return analysis to guide investment decisions.

ORIGIN:
Completed by the Uniform Law Commissioners in 1994.

APPROVED BY:
American Bar Association
American Bankers Association

STATE ADOPTIONS:
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
District of Columbia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Maine
Massachusetts
Maryland **
Michigan
Minnesota
Missouri
Nebraska
New Hampshire
New Jersey
New Mexico
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
Rhode Island
South Carolina
Tennessee
Utah
Vermont
Virginia
Washington
West Virginia
Wyoming

** *Substantially Similar*

2003 INTRODUCTIONS:
Montana

For any further information regarding the Uniform Prudent Investor Act, please contact Michelle Clayton, John McCabe or Katie Robinson at 312-915-0195.

 SITE MAP
211 E. Ontario Street, Suite 1300
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(312) 915-0195 ~ fax (312)915-0187 e-mail the office - click here

THE UNIFORM PRUDENT INVESTOR ACT

The Uniform Prudent Investor Act reverses common law rules that restrict the investment powers of trustees. The new act requires a trustee to invest as a prudent investor would, using reasonable care, skill and caution in light of the objectives and risk tolerance of the individual trust. Diversification of assets is an obligation. Trustees can delegate investment responsibilities to experts. Within the scope of these powers and duties, trustees can choose to invest in any kind of asset that meets the objective of the specific trust.

1. What are the specific advantages of the Uniform Prudent Investor Act?
2. Trusts are likely to achieve a better return for beneficiaries than is the case under the common law rules.
3. Trustees can protect the trust corpus better through diversification of assets than is the case under the common law rules.
4. Trustees can invest to counter the effects of inflation, something that the common rules do not allow.
5. A trustee no longer is forced to rely upon his or her own knowledge and expertise, but can acquire investment services to enhance his or her own knowledge and skill.
6. Trustees can take into account the changing character and kinds of assets available for investment, free of archaic restrictions.
7. Trustees are judged on overall performance of the assets in a trust, rather than on the performance of specific assets.
8. The specific needs of each trust can be taken into account in devising investment strategy, rather than be subordinate to generic investment rules treating all trusts as the same.
9. The Act will provide uniformity of law, necessary in an interstate investment environment.

UNIFORM PRUDENT INVESTOR ACT

Trustees of trusts and like fiduciaries have been subject to rules severely restricting the types of investment modalities in which they can invest the assets of the trusts that they administer and manage. Interest bearing instruments -- safe income -- of limited kinds (no junk bonds) are the limit of risk permitted or thought to be permitted under the traditional rules. Protect the paper value of the principal at all costs is the mandate for trustees. In addition, a trustee's performance is rated by the performance of each and every investment, singly, and not on the performance of the whole of the portfolio. And trustees have been precluded from obtaining professional investment help.

The result for trusts is modest income production at best without regard for the erosion of a trust's assets by inflation. Can it be that these rules miscalculate the real risk and actually jeopardize the assets of a trust rather than provide for their protection?

The answer is yes. And a remedy is now at hand in the Uniform Prudent Investor Act (UPIA), promulgated by the Uniform Law Commissioners in 1994. The adoption of this act by the state legislatures will correct the rules, based on false and damaging premises, that now govern the actions of trustees.

By no means does UPIA turn trustees into unrestrained speculators. It provides rules governing investment that, in fact, result in greater protection for the trust's assets while providing a prospect of better income. UPIA does not encourage irresponsible, speculative behavior, but requires careful assessment of investment goals, careful analysis of risk versus return, and diversification of assets to protect them. It gives the trustee the tools to accomplish these ends. UPIA requires trustees to become devotees of "modern portfolio theory" and to invest as a prudent investor would invest "considering the purposes, terms, distribution requirements, and other circumstances of the trust" using "reasonable care, skill, and caution."

The trustee has a list of factors which must be considered in making investment decisions, including "general economic conditions," "possible effect of inflation or deflation," "the expected total return from income and the appreciation of capital," and, "other resources of the beneficiaries." The trustee must take tax consequences of investment decisions into account. There is a positive obligation to diversify assets "unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." The trustee's obligations are significant, requiring sophisticated approaches to investment that really take into account the right risk to return ratio for the particular trust.

In addition, a trustee's performance in UPIA is measured by the performance of all the assets together. A loss with respect to a single asset does not mean that the trustee has violated his or her fiduciary responsibilities. The act takes the truly holistic approach to investment practices.

In return for these obligations, UPIA removes any restrictions upon the types of investment modalities which may be chosen in a trust's portfolio. It is quite possible, for example, to hold positions in high-interest bonds (junk bonds) or mutual funds investing in such bonds, in a diversified portfolio, if such an investment meets the needs of the particular trust in light of the risk/return analysis specific to that trust.

One of the boons to trustees of smaller trusts is the ability to invest in mutual funds. Mutual funds reduce investment risk by diversifying their portfolios. By using mutual funds, a trustee of a trust that does not have a large enough corpus to effectively diversify its assets can enhance diversification of the trust's portfolio to limit the trust's risk of loss.

UPIA also permits the trustee to delegate investment and management functions "that a prudent trustee of comparable skills could properly delegate under the circumstances." Careful selection of the agent and careful, periodic review of the agent's actions are part of the trustee's responsibility when delegating authority. An agent has a responsibility of reasonable care in conducting the delegated business of the trust.

Why is it that the prudent man rule of prior law may, in fact, jeopardize the assets in a trust? Some of the instruments in which trustees have been able to invest have become more volatile in price. Treasury bonds, for example, long thought to be safe investments, now fluctuate considerably in value with the fluctuation of interest rates. The former so-called safe investment may not be so safe anymore. In contrast, common stocks have shown consistently better returns over the years than bonds -- yet trustees have been prevented from investing in common stocks. Stocks have been historically safer investments, therefore, in diversified portfolios than bonds have been. Trusts have been deprived of return at some greater risk by the antiquated rules that govern investment of their assets.

By far the most insidious damage to trust assets comes from inflation. If trustees cannot invest in modalities that exceed the rate of inflation in return, the inevitable result is diminution of the corpus of the trusts they manage. The beneficiaries of trusts so restricted lose in all ways, both with respect to income and principal.

The UPIA provides rules that can be modified or waived in the trust agreement. Any person who wishes to put property in trust and who wants to provide different standards of conduct for the trustee is permitted to do so under UPIA.

UPIA provides a reasonable approach to the investment of trust assets that better meets the needs of beneficiaries while preserving trust assets. It should become the law in every state as soon as possible.