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# **Delegating Investment Authority**

## **Practical Considerations for Fiduciaries**

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*This information is intended as an opportunity for discussion and the exchange of ideas for educational purposes among trust professionals. Materials do not constitute legal, compliance or investment advice or recommendations. This content should not be used for anything other than general informational purposes. Specific questions should be referred to qualified legal and compliance professionals familiar with your specific situation.*

# Executive Summary

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- Adoption of the Uniform Prudent Investor Act has created both opportunities and challenges for Trustees with respect to their investment responsibilities.
- As the market environment grows increasingly complex, and organizational resources evolve, firms are seeking solutions to help balance strategic priorities and day-to-day decision-making
  - and –
  - are more and more in need of specialized expertise, systems, and services to meet their clients' unique needs.
- DISCUSSION TODAY:
  - Current state of delegated investment management
  - Practical considerations when considering delegation strategies
  - Industry trends impacting clients & delegation decisions

# Quick History Lesson

## *A trustee's life prior to Modern Portfolio Theory*

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- Historically a trustee's role was often less complex and those serving were thought to be chosen for specific qualities, requiring them to personally perform their duties as fiduciaries
- Delegation of investment authority, even for good reason, may have constituted a breach of trust unless the terms specifically authorized
- Thus a trustee was ostensibly a "one-man band", personally performing all the tasks and duties required of their role

# UPIA & Delegation

*How MPT & Prudent Investor changed the delegation landscape\*\**

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- Sound diversification is fundamental to risk management and is ordinarily required of trustees.
- Risk and return are so directly related that trustees have a duty to analyze and make conscious decisions concerning the levels of risk appropriate to the purposes, distribution requirements, and other circumstances of the trust.
- Trustees have a duty to avoid fees, transaction costs, and other expenses not justified by the needs and realistic objectives of the trust's investment strategy.
- A trustee's duty to be impartial toward all beneficiaries requires a trustee to balance investment returns between producing current income and maintaining and promoting future purchasing power.
- Trustees may have **a duty as well as the authority to delegate** investment authority as a prudent investor would.

*\*\* Fundamental changes under UPIA, Restatement (Third) of Trusts*

# Rules for Delegating Authority

*From the Third Restatement of the Law of Trusts*

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*"A trustee has a duty personally to perform the responsibilities of the trusteeship **except as a prudent person of comparable skill might delegate those responsibilities to others.** In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter, in supervising or monitoring agents, the trustee has a duty to exercise fiduciary discretion and to act as a prudent person of comparable skill would act in similar circumstances."*

**Section 80, Restatement (Third) of Trusts**

*"Delegation is not limited to the performance of ministerial acts. In appropriate circumstances **delegation may extend, for example, to the selection of trust investments of the management of specialized investment programs,** and to other activities of administration involving significant judgment."*

**Section 80, Comment e, Restatement (Third) of Trusts**

# So What Can Be Delegated?

*"...whether, to whom, and in what manner..."*

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*"The qualities and qualifications for which trustees are properly selected for fiduciary roles, and the scope and complexity of the investment programs of some trusts, are so diverse that **prescriptions for prudent behavior in the delegations of investment functions cannot be expressed in simple and precise legal rules.**"*

Section 80, Comment f, Restatement (Third) of Trusts

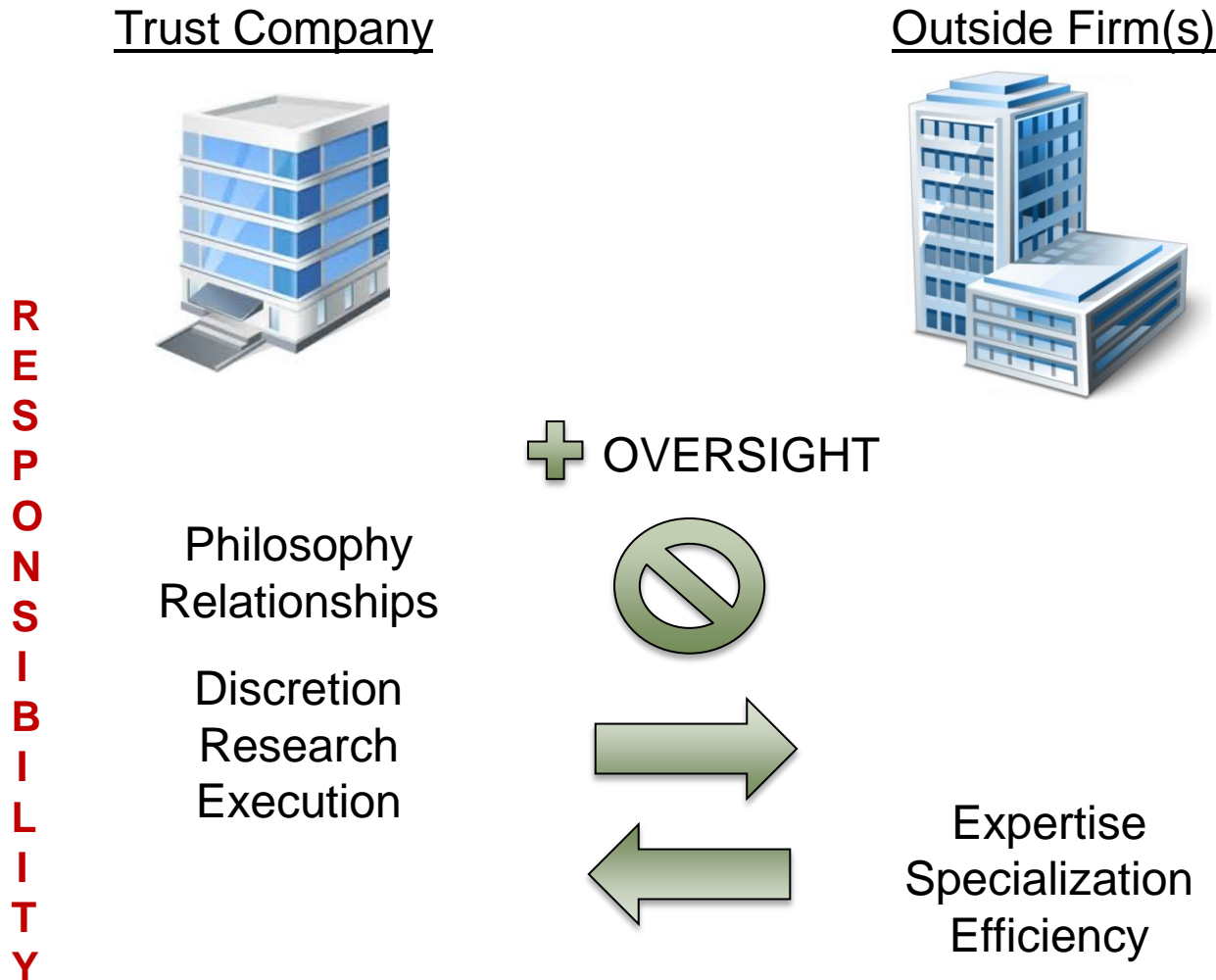
## GENERAL GUIDELINES

- Trustee must:
  - "at least define the trust's investment objective"
  - "formulate or approve the trust's investment strategies or programs"
  - "exercise care, skill, & caution in determining what investment responsibilities to delegate"
- "Fiduciary prudence must be exercised in selecting an agent and establishing terms of the delegation"

Section 80, Comment f, Restatement (Third) of Trusts

# Simple Delegation Model

*How it is supposed to work*



# Why Delegate?

*Considering how delegation fits your unique value proposition*





# Selection & Oversight

*exercising "care, skill, & caution"*

Identify Resources	Define "suitable to exercise the delegated function" <ul style="list-style-type: none"><li>- Take into account the specific ask</li><li>- Consider their unique expertise (i.e. value-add)</li><li>- Compare alternatives</li><li>- Seek advice</li></ul>
Establish Scope	Formally define scope & terms of the delegation, including: <ul style="list-style-type: none"><li>- Clear expectations</li><li>- Accountability</li></ul>
Periodically Review	<i>Lather. Rinse. Repeat</i>
Control Costs	Consider overall benefits & (all) costs

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# Example: Asset Management

*Due diligence considerations for outside managers*

		<u>Considerations</u>		
WHO	• Firm Background	History	Tenure	Industry Changes
	• Management/Personnel	Acquisitions		Reputation
HOW	• Investment Methodology		Alignment	Consistency
	• Risk Management Processes		Commitment	
WHAT	• Investment Performance	Client Needs	Oversight Needs	
	• Compensation/Fees		Long-term view	
	• Reporting Capabilities	Peer-to-peer	& Peer-to-alternative	

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# What's New?

## *Current "megatrends" in investment management*

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- Aging / Changing Demographic
- Fintech Disruption
- Active v. Passive (*v. Passive?*)
- Fee Compression
- (More) Complex Instruments
- Impact Investing

# Final Thoughts

*a few additional things to consider...*

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- Would your current business model be improved through delegation of all/part of your investment authority? How about five years from now?
- Who has ownership of your delegation decisions and strategies?
- Is BCP part of your decision framework? What changes (internal or external) could trigger looking again at your current strategies?
- If you currently delegate, how often do you review your overall strategy? Would your clients be well served from bringing certain aspects back in-house?
- How do affiliate situations impact your delegation strategies?

# Discussion & Wrap-Up

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- Your questions?

# THANK YOU!

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# Appendix: Prudent Investor Rule

## *From the Restatement of the Law Third, Trusts*

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### **§ 227. General Standard of Prudent Investment**

The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.

- (a) This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
- (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
- (c) In addition, the trustee must:
  - (1) conform to fundamental fiduciary duties of loyalty (§ 170) and impartiality (§ 183);
  - (2) act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents (§ 171); and
  - (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (§ 188).
- (d) The trustee's duties under this Section are subject to the rule of §228, dealing primarily with contrary investment provisions of a trust or statute.