UN-MEASURED is UN-MANAGED
Opinion Regarding Safe Haven for Delegation to an Investment Advisor Probate Code 16052(c)

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According to Probate Code section 16048, a Trustee " ...has a fiduciary duty to diversify the investments of the trusteeship…". Just like all other investment management duties, diversification is quite complicated and not something a non-expert should be tasked with. Thus, delegating responsibility for the diversification functions for your Trusteeship's portfolio to an investment professional is the prudent thing to do for a Trusteeship as well as the Trustee.

The California Uniform Prudent Investor Act, grants Trustees power to delegate investment management duties to a professional investment manager, and provided the delegation is accomplished in a "prudent" manner it also transfers fiduciary liability from the Trustee to the agent for decisions and actions of the agent [see Probate Code section 16052(c)]. But making an imprudent delegation, even one you sincerely believe to be prudent, can be disastrous. So before you hand off diversification responsibilities, you better be sure the hand-off is done prudently.

Probate Code section 16052(a) states that "… "A trustee may delegate…" [If] "The trustee shall exercise prudence in the following:" and then goes on to lists 3 basic duties that can only be performed by the delegating Trustee. If left to the delegee, or worse not performed at all, the delegation is deemed imprudent causing fiduciary liability to remain with the Trustee.

(1) Selecting an agent.
(2) Establishing the scope and terms of the delegation.
(3) Periodically reviewing the agent's overall performance.

Exercising prudence requires selecting an agent who is capable of being held to an "expert's standard of care". Otherwise, the delegation will be imprudent. An "expert's standard of care" in reasonably reducing Uncompensated Risk (UCR) matters begins with an in depth knowledge of all of the UCR metrics. It also requires the requisite technology and knowledge for applying diversification metrics to quantify the absolute amount of UCR present in a portfolio and measure the effectiveness of both absolute and relative UCR removal. At a minimum, a delegating Trustee must confirm that his/her agent's technology is capable of calculating and quantifying those diversification metrics and the agent is capable applying the results. A third party expert opinion is also desirable.

Close coordination between Trustee and a knowledgeable agent is required under sub section (2) to successfully establish the scope and terms for delegation of uncompensated risk management. Without an expert's assistance, it is impossible for most Trustees to meet this high standard.

Some trustees mistakenly believe that sub-section (3) can be easily satisfied with a signed, written memo, delivered annually by the agent stating that it is his/her professional opinion that the Trusteed portfolio reasonably satisfies the standards for diversification and the removal of Uncompensated Risk of Modern Portfolio Theory. But because the memo lacks any detail, the agent's signed memo only proves that the Trustee's required periodic performance and compliance reviews never took place, which is, ipso facto, imprudent. In fact, suggesting that a signed diversification memo satisfies the requirements for achieving a compliant delegation is a bad faith failure to ascertain certain facts, which for a Trustee, is by itself, another breach of fiduciary duty.

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