

CONSIDERATIONS FOR TOWN TRUSTEE'S INVESTMENT POLICY

During our 2017 annual meeting with the Town Council we were asked, "Why do you have an investment advisor who charges a relatively large fee in relation to earnings; why not just invest the funds in an indexed mutual fund?" The answer to this question has several parts, which we can hopefully make clear in this statement.

First, the Trustees concluded that the Town's interests would be better served if the funds held in the various reserves and trusts in the custody of the Trustees could be invested to produce more income. Better earnings would obviously increase the ability of the reserves and trusts to provide resources to carry out the purposes for which the reserves and trusts were created. Our conclusion was based on the belief that the 0.1% to 0.25% interest then being earned in the bank account where the funds were then held could be significantly improved upon, without having to accept undue risk.

In order to invest the funds in reserves and trusts the Town must follow a rather specific legal route:

31:25-d Application of Prudent Investor Rule. – The trustees of trust funds may manage and invest such funds in accordance with the prudent investor rule under RSA 564-B:9-901--RSA 564-B:9-906 without regard to the investment limitations of RSA 31:25 and RSA 31:25-a, provided, however, the trustees of trust funds:

I. Notify the attorney general in writing of their decision to invest according to the prudent investor rule; and

II. Hire or employ the trust department of a bank or a brokerage firm to provide investment advice and assistance under RSA 31:38-a, III .

31:38-a Professional Banking and Brokerage Assistance. –

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III. Any trustee or trustees of trust funds authorized by this chapter may hire or employ the trust department or departments of a bank or banks or a brokerage firm to assist in the management and investment of trust fund resources or to provide bookkeeping services in connection therewith or to do both. They may also place securities in the nominee name of a trust department or departments or a brokerage firm to facilitate transfers for such securities. Trust fund records maintained by any bank or brokerage firm must be available at all times for examination by local auditors, by independent accountants or auditors retained by a municipality, or by the auditors of the department of revenue administration; and such records shall be municipal records and property. In employing such trust departments, portfolio management departments, or investment advisors, the trustees may enter into contracts or agreements delegating the management of such trust funds to those departments subject to investment guidelines adopted by the trustees under applicable statutes and subject to at least quarterly review and approval of such management by the trustees.

At the Trustee's request, The Town Council adopted "the Prudent Investor rule" in Resolution 2014-14. This action enabled the Trustees to open an investment account and required the Trustees to engage an investment advisor. The goal of recommending Resolution 2014-14 was to

get a better return on the funds held in trusts and capital reserves by the Town while providing due care for preservation of capital.

Second, the trustees chose to hire a bank as investment advisor, rather than a broker or trust company. The rationale for this decision was explained in a detailed memorandum to Council on trust funds management dated 20 April 2016. In brief, this rationale is that bank trust departments are actively supervised by the Comptroller of the Currency, part of the US Treasury Department, while other investment advisory services are supervised by industry groups or state banking agencies. The trustees feel that supervision by semi-independent federal office was a better choice. Investment advisory fees do not vary widely, despite what some advisers might advertise, so there does not appear to be a reason not to choose a bank trust department.

Third, the legal standard of care for trustees management of trusts and reserves is expressed in: (bold for emphasis; strikethrough for not applicable to Towns):

CHAPTER 564-B NEW HAMPSHIRE TRUST CODE

ARTICLE 9 UNIFORM PRUDENT INVESTOR ACT

564-B:9-902 Standard of Care; Portfolio Strategy; Risk and Return Objectives. –

(a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

- (1) general economic conditions;***
- (2) the possible effect of inflation or deflation;***
- (3) ~~the expected tax consequences of investment decisions or strategies;~~***
- (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, ~~interests in closely held enterprises, tangible and intangible personal property, and real property;~~***
- (5) the expected total return from income and the appreciation of capital;***
- (6) other resources of the beneficiaries;***
- (7) any other trust if one or more of the beneficiaries also are beneficiaries of that trust;***
- (8) needs for liquidity, regularity of income, and preservation or appreciation of capital;***

and

(9) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets. For purposes of subsections (c)(6) and (c)(7), the trustee has a duty

to investigate the relevant information and a duty to monitor the relevant information, and the trustee is not liable to any person to the extent that the trustee performs those duties in good faith and, in accordance with this section, considers the information that the trustee obtains through the good faith performance of those duties.

(e) A trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

Source. 2004, 130:1, eff. Oct. 1, 2004. 2014, 195:27, 40, eff. July 1, 2014.

New Hampshire's Uniform Prudent Investor Act was carefully coordinated with national standards of care for trusts as part of an effort to make trust law common between states. Massachusetts trust law is similarly coordinated. In what has become a landmark decision on the standard of care, the Massachusetts Supreme Judicial Court's 2014 decision in *Woodward School for Girls v. the City of Quincy* is instructive:

Summary Opinion (Justia)

The City of Quincy (Quincy) served as trustee of the Adams Temple and School Fund and the Charles Francis Adams Fund (together, the Funds) through two boards. The Woodward School for Girls, Inc. (Woodward) has been the sole income beneficiary of the Funds since 1953. In 2007, Woodward filed suit against Quincy seeking an accounting and asserting that Quincy committed a breach of its fiduciary duties in several respects. A probate and family court judge concluded that Quincy committed a breach of its fiduciary duties by failing to invest in growth securities and failing to heed certain investment advice, removed Quincy as trustee, and ordered Quincy to pay a nearly \$3 million judgment. The Supreme Judicial Court affirmed the judgment as to liability, reversed with respect to the calculation of damages on the unrealized gains, and remanded, holding (1) Woodward's claims were not barred on the grounds of sovereign immunity, the Massachusetts Tort Claims Act, or laches; (2) the judgment against Quincy for committing a breach of its fiduciary duties to the Funds was proper; (3) the award of damages was erroneous in the calculation of unrealized gains on the investment portfolio; and (4) the judge did not err in including prejudgment interest.

It should be noted that the MA SJC remanded the case to a lower court for re-calculation of damages consistent with its decision (see decision at: <https://cases.justia.com/massachusetts/supreme-court/2014-sjc-11390.pdf?ts=1406127887>.)

A summary statement of a trustee's standard of care responsibility is thus:

1. Preservation and appreciation of capital.
2. Regularity of income
3. Liquidity sufficient to pay for authorized expenditures.

The Durham Trustees of Trust Funds Investment Policy (posted on the Trustee's web page) was specifically constructed to carry out this responsibility. The Trustees feel that the results achieved in the Trustee's investment account over the past three years demonstrate that the management of the Town's trusts and reserves is lawful, appropriate and successful.

Fourth, as to why not just an index mutual fund. The Trustees have chose to limit the exposure of town reserves and trusts to 20% equity investments, except for Cemetery Trusts which are limited to 25%. The Cemetery funds exposure is greater in recognition of the perpetual nature of these trusts as well as the need to try to grow the principal of these mostly small principal accounts. This overall limitation is rooted in the preservation of capital concept embedded in the standards of care discussed above. An equity investment's value rises and falls with the market, as well as with the success or failure of the underlying business(es). Reserves and trusts are money set aside for a purpose, in the expectation that when the purpose requires funding, the money will be available. Should the value of an investment decline, the expected money may not be there, or only be there in part. The Trustees feel that we would not be living up to our responsibilities to ignore the importance of the preservation of capital to our role.