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How Much Is Too Much? A View on Concentration of Assets in Trusts

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Experienced and professional trustees may be familiar with the concept of asset concentration and its attendant risks. For others, and those needing a refresher, consider the inherited circumstances of Lincoln First Bank, N.A. (Lincoln Bank), the testamentary corporate trustee in the decedent's estate of Rodney B. Janes, a former New York State Senator and businessman.

According to the oft-cited New York Court of Appeals decision, Lincoln Bank was nominated and appointed to serve as trustees of three trusts that each received a share in the decedent's stock portfolio, valued at approximately $2.5 million at the time of his death in 1973. *Matter of Est. of Janes,* 90 N.Y.2d 41, 53 (1997).

Most of it was held in Kodak stock, each share trading for about $139 shortly after the time of appointment. Rather than promptly evaluating and diversifying that position, the trustee permitted the concentration to persist as Kodak's value declined precipitously. By March 1978, the price collapsed to an astonishing $40 per share, and the "blame game" ensued. Lincoln Bank was ultimately found liable and surcharged.

The issue of asset concentration presents immediate and often difficult challenges for any fiduciary tasked with managing a trust under such circumstances. A portfolio dominated by a single holding invites risk and places the trustee squarely within the crosshairs of the prudent investor rule. What follows is a framework to guide such trustees, tasked with steering concentrated portfolios through uncertain terrain.

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Prudent Investor Rule Generally

All trustees must begin with the Prudent Investor Act, or New York Estates, Powers, and Trusts Law (EPTL) §11-2.3. The Prudent Investor Act sets forth the "prudent investor rule," which provides that a trustee has a duty to invest and manage trust assets in accordance with the "prudent investor standard." Notably, the prudent investor rule requires a standard of conduct, not outcome or performance. Conformity is adjudged in light of all the surrounding facts and circumstances prevailing at the time of the decision or action of a

trustee. EPTL §11-2.3(b)(1); *In re Hyde*, 44 A.D.3d 1195, 1198 (3d Dep't 2007).

The Prudent Investor Act applies to investments made or held on or after Jan. 1, 1995. Prior to Jan. 1, 1995, New York followed the prudent person rule, and before 1970, courts followed common-law principles elucidated under *King v. Talbot,* 40 N.Y. 76 (1869). Given the time horizon for the administration of trusts, it is no surprise that a single analysis on the trustee's investment management may span different regimes and governing standards. See *In re Knox*, 98 A.D.3d 300 (4th Dep't 2012).

The prudent investor standard requires a trustee "to pursue an overall investment strategy to enable the trustee to make appropriate present and future distributions to or for the benefit of the beneficiaries under the governing instrument, in accordance with risk and return objectives reasonably suited to the entire portfolio" and "to diversify assets unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify, taking into account the purposes and terms and provisions of the governing instrument." EPTL §11-2.3(b)(3)(A), (C).

The diversification mandate of the prudent investor rule is generally consistent with the diversification standards developed by the courts under the prior prudent person rule. *Hyde*, 44 A.D.3d at 1198. The new statutory construct made diversification the presumption, with an opt-out "if the beneficiaries require otherwise or if the testator/settlor directed a different course of action." *Knox,* 98 A.D.3d at 301.

In its determination of investment strategy, a trustee must consider "the size of the portfolio, the nature and estimated duration of the fiduciary relationship, the liquidity and distribution requirements of the governing instrument, general economic conditions, the possible effect of inflation or deflation, the expected tax consequences of investment decisions or strategies and of distributions of income and principal, the role that each investment or course of action plays within the overall portfolio, the expected total return of the portfolio (including both income and appreciation of capital), and the needs of beneficiaries (to the extent reasonably known to the trustee) for present and future distributions authorized or required by the governing instrument." EPTL 11-2.3(b)(3)(B).

For example, in *In re HSBC Bank USA*, 37 Misc. 3d 875 (Sur. Ct. Erie County 2012), objectants alleged that the fiduciary acted imprudently in its "acquisition and/or retention" of shares of four public companies, arguing that the fiduciary's holdings of these shares constituted imprudent concentration.

The court rejected objectants' contention and ruled that the fiduciary complied with the prudent investor standard because the stocks were on the trustee's internal list of approved stocks, the selection accorded with a beneficiary's direction to focus on long-term growth, the trustee fully complied with its internal policies regarding acceptable equity holdings in relation to the stocks within the entire portfolio, and the trust's performance and investment strategy was reviewed at least annually.

The court concluded that "the record demonstrates a thoughtful, well-considered evaluation by the trustee of the portfolio and the stocks it held, and the trustee came to a balanced approach to managing the assets under all the circumstances."

By contrast, in *In re Hunter*, 100 A.D.3d 996 (2d Dep't 2012), the court held that the trustee violated the Prudent Investor Act by maintaining a concentrated position in a company's stock because the trustee never formulated any investment plan for the trust that included diversification of the concentration of the stock, acted contrary to its own internal policies, and failed to establish that it took steps to determine whether it was in the interests of the beneficiaries to retain non-diversified holdings in the trust in light of the purposes and terms of the trust and the provisions of the governing instrument.

Duty of Initial Review

The prudent investor standard also requires a trustee, "within a reasonable time after the creation of the fiduciary relationship, to determine whether to retain or dispose of initial assets." EPTL 11-2.3(b)(3)(D). New York courts have clarified that a trustee's retention of an asset received by the grantor of the trust may be found to be prudent even when purchase of the same asset might not. See *In re JP Morgan Chase Bank, N.A.*, 133 A.D.3d 1292, 1298 (4th Dep't 2015). Accordingly, a trustee's decision to retain property—including real property—received in-kind to a trust should be afforded more leniency than a trustee's decision to purchase a new investment. *Matter of Weber as Tr. of Michael S. Weber Tr.,* 85 Misc. 3d 727, 730 (Sur. Ct. Saratoga County 2024).

Guideposts for Trustees

Several factors, drawn from the EPTL and New York case law, can justify a trustee's decision to retain a concentrated real property position. These factors include:

· **Illiquidity and Lack of Marketability.** EPTL §11-2.3(b)(3)(B) expressly requires the trustee to consider such factors. In *Hyde*, 44 A.D.3d at 1195, the court held that unmarketability was a primary justification for retaining a concentrated holding of the stock of a closely held corporation, which would only be possible to sell at a speculative price given the absence of a market.

· **Tax Consequences.** EPTL §11-2.3(b)(3)(B) expressly requires consideration of "the expected tax consequences of investment decisions or strategies and of distributions of income and principal."

· **Grantor Intent and Provisions of Governing Instrument.** Under EPTL §11-2.3(b)(3)(C), the diversification determination must take "into account the purposes and terms and provisions of the governing instrument." Referring to *Hyde*, 44 A.D.3d at 1195, in holding the fiduciary did not act imprudently in determining not to diversify the trust's holding of closely held corporation stock, the court gave substantial weight to the "indication that the settlors of the trust wanted the ownership of [the company] to remain in the family and the trusts were used as vehicles to achieve such a result" and stated that the family nature of the corporation is a material consideration in diversification decisions.

· **Income Generation and Appreciation.** If the concentrated real property holding generates substantial rental income, appreciates steadily, or outperforms alternative investments, retention is more justifiable. In *In re JP Morgan Chase Bank*, N.A., 133 A.D.3d 1292 (2015), the court held that it would be unreasonable to hold that the fiduciary acted imprudently in retaining assets that had appreciated or were appreciating in value and were providing significant income."

· **Trust's Ability to Meet Distribution Obligations.** In *Weber,* 85 Misc. 3d at 727, the court noted that the trust was able to meet all its obligations to the beneficiary throughout the period of retention, and that the real property had no impact on the trust›s ability to provide financial support. This factor is specifically contemplated by EPTL §11-2.3(b)(3)(B)›s requirement to consider "the liquidity and distribution requirements of the governing instrument" and "the needs of beneficiaries (to the extent reasonably known to the trustee) for present and future distributions authorized or required by the governing instrument."

· **Portfolio Context and Size.** Courts have rejected evaluating concentrated holdings "in a vacuum"—the assessment must take into account what other assets the trust holds. HSBC, 37 Misc.3d at 875. A 16% real property concentration (as in *Weber*, 85 Misc. 3d at 727) is treated differently than a 71% concentration (as in *Matter of Est. of Janes*, 90 N.Y.2d at 51).

Duty of Loyalty

It is not news that trustees also owe an undivided duty of loyalty to the beneficiaries of a trust. That

duty has been said to be an exacting, “inflexible rule of fidelity” (*Birnbaum v. Birnbaum* 73 N.Y.2d 461, 466 (1989)), transcending mere “honesty alone” and requiring a standard of behavior of the “honor the most sensitive” (Meinhard v. Salcmon, 249 N.Y. 458, 464 (1928)).

Even the greenest trustee and practitioner should, accordingly, be familiar with the so-called “no further inquiry rule,” where New York courts generally invalidate self-dealing transactions without regard for the details of the transaction itself except for the proof of its self-dealing nature. See, e.g., *Matter of Rothko*, 43 N.Y.2d 305 (1977); *In re Heller,* 6 N.Y.3d 649 (2006); *In re Parisi*, 111 A.D.3d 941 (2d Dep’t 2013); *City Bank Farmers Trust Co. v. Cannon*, 291 N.Y. 125 (1943). This strict prohibition can, however, be relaxed by the terms of the trust instrument itself (see, e.g., Bavers v. Shepherd, 189 A.D.3d 606, 609 (1st Dep’t 2020)), even to provide a corporate trustee the authority to purchase and hold its own stock. See HSBC Bank USA, N.A., 98 A.D.3d at 313-4.

Nevertheless, such clauses, as well as exculpation clauses in trust instruments generally, regardless of how broad they appear, cannot shield trustees from all liability. Under EPTL 11-1.7 as amended in 2018, trustees of *inter vivos* trusts executed on or after Aug. 24, 2018, cannot be exonerated from liability for “failure to exercise reasonable care, diligence and prudence.”

A generally more relaxed standard applies, however, to trustees of inter vivos trusts executed before Aug. 24, 2018, as New York courts before the 2018 EPTL amendment developed a lower minimum standard of care based upon a loosely defined “good faith standard,” permitting the exoneration of a trustee for failure to exercise reasonable care. See *O’Hayer v. de St. Aubin,* 30 A.D.2d 419, 423 (2d Dep’t 1968) (holding that a trustee’s liability cannot be limited for acts taken “in bad faith or intentionally or with reckless indifference to the interests of the beneficiaries, or if he has personally profited though a breach of trust”); see also *In re Jastrzebski,* 97 A.D.3d 819 (2012); *Lange v. Kooper*, 28 A.D.3d 240 (1st Dep’t 2006).

Damages

Where a fiduciary’s imprudence consists solely of negligent retention of assets it should have sold, the measure of damages is the value of lost capital. *Janes*, 90 N.Y. at 320. Capital lost is determined by subtracting from the value of the stock on the date when it should have been sold from the sales proceeds from the actual date of sale (or present value of the stock if retained by the estate). Interest may also be awarded at the discretion of the trial court. Dividends and other income attributable to the retained assets should offset any interest awarded, and the court should consider the capital gains that may be owed if the stock were sold. See *In re Saxton*, 274 A.D.2d 110, 120-21 (3d Dep’t 2000).

But where the fiduciary’s misconduct consisted of deliberate self-dealing and faithless transfers of trust property, the damages are calculated through “lost profits” or “market index” and may take into consideration appreciation damages. *Janes*, 90 N.Y.2d at 55; *Rothko’s Est.*, 43 N.Y.2d at 320-22.

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