

The Trustee Act 2000 and the modern meaning of 'investment'

Andrew D Hicks*

Introduction

The Trustee Act 2000 (TA 2000) creates a new regime for trustee investment by replacing the restrictive provisions of the Trustee Investment Act 1961 (TIA 1961). In contrast to the legal list of 'authorised investments' in the TIA 1961, section 3(1) of the TA 2000 confers on a trustee broad powers to 'make any kind of investment that he could make if he were absolutely entitled to the assets of the trust'. The precise extent to which the investment powers of trustees are extended, however, depends on the meaning given to 'investment'.

'Investment' is not defined by the TA 2000 and is potentially of broad meaning.¹ However, in the context of the law of trusts the term has been traditionally defined restrictively as the purchase of an asset for the purpose of yielding income.² In contrast to current investment practice, assets that yield no income are therefore not deemed to be 'investments'. The traditional view is usefully contrasted with that of the Law Commission, which recently opined that 'the notion of what constitutes an investment is an evolving concept to be interpreted by the courts', and hence includes assets purchased for the purpose of capital appreciation.³ The Commission's treatment of this issue was confined to a footnote, however, and did not address the relevant considerations in any degree of detail.

Perhaps partially as a result of its brief treatment by the Law Commission, and as a result of its treatment in the current editions of the leading texts,⁴ there continues to be confusion about the precise meaning of investment for the purpose of trust law. Consequently, it appears that a number of trustees continue to follow the traditional meaning of investment and avoid what are otherwise viewed as prudent and suitable investments on the ground that they do not yield an

* My thanks to NDM Parry and an anonymous referee for discussion and comments.

1. At its broadest, 'investment' has been defined as that which is acquired from laying out money in the purchase of property: *IRC v Rolls Royce* [1944] 2 All ER 340, 341–342 per Macnaughten J, *Taxes Commissioner v Australian Mutual Provident Society* (1902) 22 NZLR 445, 450 per Stout CJ; *Re Will of Sheriff* [1971] 2 NSWLR 438, 442 per Helsham J. The courts have also on occasion stressed the somewhat permanent nature of an investment, suggesting it is the 'antithesis of ready money': *Re Ferry, Ferry v Allen* [1945] NZLR 448, 451–452 per Kennedy J; *In re Somerset, Somerset v Earl Poulett* [1894] 1 Ch 231, 247 per Kekewich J, suggesting '[t]he object of trustees must ever be to make a permanent investment, that is, one which will be maintained for a considerable period'. Other courts have suggested that investment covers any mode of application of money or other property that is intended to return a profit, whether by way of income or capital: *Culverden Retirement Village v Registrar of Companies* [1997] NZLR 257, 261 (PC); *Kerr v Visa Vacations Pty Ltd* (1986) 11 ACLR 14; *Taxes Commissioner v Australian Mutual Provident Society* (1902) 22 NZLR 445, 456–457 per Edwards J.
2. See the discussion of *Re Power*, *infra*.
3. Law Commission, *Trustees' Powers and Duties* (Law Com 260, 1999) paragraph 2.28, n 56.
4. In the context of the interpretation of express investment clauses some of the current texts accept the traditional meaning of investment without question: see, for example, Martin, *Modern Equity* (15th edn, 1997) p 514; Hayton, *Underhill & Hayton Law Relating to Trusts and Trustees* (15th edn, 1995) p 592. Others are of the opinion that the meaning of investment is a matter of great uncertainty: Pearce & Stevens, *The Law of Trusts and Equitable Obligations* (2nd edn, 1998) p 535. In its consultation paper the Law Commission concluded that the traditional meaning 'must be taken as still representing the present law': Law Commission consultation paper No 146, *Trustees' Powers and Duties* (1997) paragraph 8.5.

income. The Charity Commission, for example, has recently issued operational guidance advising that 'investment in this sense does *not* include an asset from which the only prospect of a positive economic return lies in an uplift of its market value'.⁵

The purpose of this article is to resolve this confusion. It is in fact clear that the traditional meaning of investment no longer persists in the law of trusts for a number of reasons. First, the authority for such a meaning is weak and inconclusive. Second, there has been a recent proliferation of investments that do not produce income but which may nevertheless enhance effective trust fund management. Judicial authority shows that the legal meaning of investment has evolved to reflect these developments. Third, the special trust law considerations that historically conditioned a restrictive meaning of investment have no relevance today given contemporary economic conditions and increasingly sophisticated understandings of investment. Fourth, the persistence of a restrictive meaning of investment would partially frustrate the policy behind the TA 2000.

It is therefore clear that the meaning of investment for the purpose of trust law is relative and, in the absence of any special considerations to the contrary, evolves in line with commercial practice.

The meaning of investment and the law of trusts

The authority commonly cited in support of the traditional meaning of investment in the law of trusts is *Re Power*.⁶ In this case a will contained an investment clause permitting trust moneys to be 'invested by the trustee in any manner in which he may in his absolute discretion think fit in all aspects as if he were sole beneficial owner of such moneys including the purchase of freehold property in England and Wales'. The issue arose whether the trustee was permitted to purchase residential property with vacant possession for occupation by the testator's widow and children.

Jenkins J held that on true construction the clause only authorised the purchase of freehold property as an investment, and this did not extend to the purchase of freehold property for occupation by the beneficiary. He reasoned:

'there is a distinction between purchasing freehold property for the sake of the income one is going to get from it and purchasing freehold property for the sake of occupying it or permitting someone else to occupy it. In the former case, the purchase is, in common parlance, and I think also in legal parlance, accurately described as an investment. In the latter case, it is not necessarily an investment, for it is a purchase for some other purpose than the receipt of income. It may be a purchase which would not be, from the financial point of view, attractive or indeed at all beneficial, because part of the price might be attributable to the special benefit represented by the acquisition of a suitable place to live. [The clause] does not authorise the purchase of a freehold house with vacant possession as a home for the tenant for life and the testator's children, because such purchase would not be a purchase by way of investment, or, perhaps, more accurately, might not be a purchase by way of investment, inasmuch as part of the money would or might be paid for the advantage of vacant possession and the benefit which the family would get by living in the house'.⁷

5. Charity Commission, *Operational Guidance: Trustee Act 2000, General Powers of Investment* (OG Int 28 B1 – 1 February 2001). Thus, the Commission expressly advised that put options and the purchase of commodities are not investments. The view of the Commission appears to stem from Hayton, *ibid*.

6. *In re Power, Public Trustee v Hastings* [1947] 1 Ch 572.

7. *Ibid*, 575. Cf *City of London Building Society v Flegg* [1988] AC 54, 83 per Lord Oliver, suggesting in a case concerning land held on trust for sale that the 'beneficiary's possession or occupation is no more than a method of enjoying *in specie* the rents and profits pending sale in which he is entitled to share'. See now Law Commission consultation paper, *supra* n 4, Part VIII; TA 2000, s 8(1), providing trustees with the power to acquire leasehold or freehold land as an investment, for occupation by a beneficiary, or for any other reason. The section thus maintains a separation between the acquisition of land as an 'investment' and acquisition for occupation by a beneficiary.

The case thus appears to suggest that for the purpose of trust investment law the purchase of an asset will not be an 'investment' unless it produces income. Certainly this is the widely accepted view.⁸ It is, however, inconsistent with the earlier authority taken to support it.

In *Re Power* Jenkins J believed that the definition of investment he provided was 'clearly stated'⁹ in *Re Wragg*.¹⁰ However, in *Re Wragg* the relevant passage by Lawrence J read:

'Without attempting to give an exhaustive definition of the words "invest" and "investment" I think that the verb "to invest" when used in an investment clause may safely be said to include as one of its meanings "to apply money in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of the income which it will yield"; whilst the noun "investment" when used in such a clause may safely be said to include as one of its meanings "the property in the purchase of which the money has been so applied"'.¹¹

Lawrence J was thus clear that he was not attempting a comprehensive definition of the term, but merely the less ambitious task of the provision of an illustration. The commonly accepted interpretation of *Re Power* would therefore have required Jenkins J to elevate the example of investment provided in *Re Wragg* to the status of an exclusive rule.¹²

One may, however, question whether Jenkins J did intend to lay down an exclusive rule in *Re Power*. Much depends on the emphasis one gives particular words in the judgment and no small amount of second-guessing. Thus, Jenkins J stated that the purchase of a house for occupation was 'not necessarily an investment' because it was a purchase for a purpose other than the receipt of income. He then explained that such a purchase might not be financially attractive or at all beneficial because part of the price might represent a premium paid for vacant possession: where property is sold subject to an existing lease it will be purchased only as an investment and, consequently, realise a smaller price; where the same property is sold with vacant possession, the sale will attract not only investors but also prospective occupiers, hence will realise a larger price.¹³ Did Jenkins J therefore find that the purchase of a house for occupation was not an investment because it would produce no income? Or was he persuaded to find that it was not an investment because, not only would the purchase produce no income, it was also likely to be financially unattractive due to the existence of the premium?¹⁴ Or was there a third factor that was ultimately found persuasive? It is both conceivable and consistent with the judgment of Jenkins J that he was troubled by the premium paid for vacant possession because it essentially constituted an immediate, if partially obscured, distribution of the benefit of the trust to the life beneficiaries

8. See Martin, *supra* n 4, 514; *Halsbury's Laws of England* (4th edn, 2000 reissue) Vol 48, paragraph 895.

9. *Supra* n 6, 575.

10. *In re Wragg, Wragg v Palmer* [1919] 2 Ch 58.

11. *Ibid*, 64-65 (emphasis added).

12. Megarry, Note (1947) 63 LQR 421, 422.

13. *Supra* n 6, 575. See also *supra* n 10, 65.

14. This approach to the meaning of investment does, to a large degree, conflate the meaning of investment with the standard by which the investment choices of trustees are judged, and comes close to suggesting that the purchase of an asset will not be an 'investment' if it is likely to be of no benefit to the trust. A similar approach was taken by the Lord President (Cooper) in *Moss's Trustees v King* [1952] SC 523, 527, who stated that if trustees were to apply trust funds in the purchase of a house for occupation by the beneficiary on 'uneconomic terms, it would be a mere simulate device to describe the transaction as a trust "investment"'.

rather than being property which would accrue to the trust fund. There was thus a merging of the dispositive and administrative functions of the trustee in one and the same transaction that further clouded consideration of the trustee's duty of even-handedness between competing beneficiaries.¹⁵

All three lines of reasoning are consistent with the actual result in *Re Power*, but only the first conclusively rules out the purchase of non-income producing assets as investments. The second line of reasoning is capable of supporting the proposition that the purchase of an asset for purposes other than the receipt of income, while not necessarily an investment, may be an investment if it is likely to be financially attractive or otherwise beneficial to the trust.¹⁶ The third line of reasoning is also capable of supporting a similar proposition; namely that the purchase of an asset for purposes other than the receipt of income may be an investment so long as part of the purchase price does not constitute the provision of an immediate dispositive benefit to the trust beneficiaries.¹⁷ On both second and third interpretations the presence of an income-producing element in an asset is therefore illustrative of a trust 'investment' but is not a pre-requisite.¹⁸

The case need detain us no longer, however. *Re Power* is a weak authority due not only to its ambiguity but also the historical context in which it was decided. In the following parts strong evidence is produced that suggests the concept of investment has evolved to encompass a much broader meaning than the purchase of an asset for the purpose of income production, *Re Power* notwithstanding.¹⁹

The development of non-income investments

Spurred on by the rapidly changing investment environment, the past twenty-five years have witnessed a proliferation of innovative investment products and techniques. A large number of financial instruments have emerged that do not yield an income but are of great potential benefit to trusts for other reasons. Put options and futures, for example, while high risk if used speculatively to trade for their own sake, can also be used as hedges to reduce overall portfolio risk.²⁰ The use of warrants, on the other hand, can provide a low-priced way of buying into a

-
15. While the purchase of any property for the purpose of investment inevitably involves a consideration of the competing interests of beneficiaries, should they be present, the issue is further complicated where administrative/dispositive combinations occur within the same transaction. Where competing beneficial interests are present, such issues will be now faced by trustees exercising a power to purchase land for occupation by a beneficiary under the TA 2000, s 8(1).
 16. Contrast, however, the further possible interpretation of *Re Power*, discussed by Megarry, *supra* n 12, 422–423, that the purchase of an asset may not be an investment if any part of the purchase price is paid for a non-income producing element, such as the capacity for capital appreciation.
 17. This interpretation would of course raise further questions: what if property was purchased subject to a tenancy, but the tenancy was not renewed and the beneficiaries then permitted to occupy the dwelling? In this instance no premium for vacant possession is paid. On the other hand, what of the trustee that purchased freehold land in order to let to strangers? Would this have amounted to an investment, albeit one which may be deemed imprudent?
 18. However, *dicta* from broadly the same period as *Re Power* is consistent with the narrow interpretation of 'investment': *Moss's Trustees v King* [1952] SC 523, 527 per the Lord President (Cooper); *In re Peczenik's Settlement Trusts* [1964] 1 WLR 720, 723 per Buckley J. See also *In re Rooke, Rooke v Rooke* [1953] 1 Ch 716, 722 per Harman J, holding that the term 'investment' in a will was meant in its 'strict sense', hence did not permit trustees to retain a farm for occupation by a life tenant.
 19. The impact of *Re Power* has been considerably reduced in recent years since, such is its economic desirability, professionally drafted trust instruments now commonly contain clauses permitting the purchase of investments or other property whether income producing or not. See, for example, *Encyclopedia of Forms and Precedents* (5th edn, 1997 reissue) Vol 40(1) Forms 4, 148, 186.
 20. Walmsley, *The New Financial Instruments* (1988) pp 106–111; Langbein, 'The Uniform Prudent Investor Act and the Future of Trust Investing' (1996) 81 Iowa Law Rev 641, 660–662. The *Restatement (Third) of the Law of Trusts*, §227, comment e, expressly acknowledges the potential of options and futures in lowering risk while increasing expected returns of trust portfolios. For more detailed discussion of the substantial risk-reduction potential of futures see Levy, 'The Prudent Investor Rule: Theories and Evidence' (1994) 1 Geo Mason L Rev 1, 23–24.

growth company without tying up a large amount of capital for a long period.²¹ While such financial instruments are likely to be of use to relatively few large trusts, because they require active expert management, hence involve high transaction costs, this does not justify their exclusion from the range of trustee investments. The variety of goals, compositions and risk tolerances of different trusts require the greatest possible range of investments to be available to trustees if the purposes of particular trusts are to be effectively furthered. Furthermore, other innovative financial instruments are of more general use, even to smaller family trusts. Zero dividend preference shares provide a particularly compelling example.²²

As their name suggests, zeros receive no dividend income but have an agreed maturity value over and above their purchase price. As a class of preference shares they rank ahead of ordinary shares when the company is eventually wound up, hence are lower risk than income shares or other classes of capital shares.²³ Zeros are particularly attractive when the stock market is uncertain and interest rates are low because they offer good returns and, as preference shares, are relatively low risk. Furthermore, because they have a fixed life and fixed redemption price they are predictable, hence are ideal for funding known future trust liabilities. Zeros are also an efficient vehicle for the mitigation of a trust's tax liabilities. Because no dividends are paid to the trust no income tax is payable. Any capital gain realised at the redemption date or upon sale of the shares is subject to capital gains tax, but this gain may be within the trust's annual capital gains allowance. By contrast, any income received from investments is liable to income tax at the basic rate, their being no equivalent income tax allowance for trusts. Investment in zero dividend preference shares may therefore be both prudent and in the best financial interests of the beneficiaries, notwithstanding that they produce no income.

It is thus apparent that, while a growing number of new financial instruments are potentially of great benefit to a wide range of trusts, many do not fall within the traditional meaning of 'investment' because they are not purchased for the purpose of income production.²⁴ Consequently, if the traditional meaning of investment persists, some trustees will be prevented from making prudent investments that are widely accepted by the financial community, appropriate to the needs of the particular trust and in the best financial interest of the beneficiaries.

Recent judicial trends, however, show that the legal meaning of investment moves with these changes. In other areas where the chance for judicial consideration of the meaning of investment has recently arisen the courts have shown themselves to be particularly sensitive to the contingent nature of the term.^{24a} This is by no means an exceptional phenomenon and, in the

21. Walmsley, *Ibid.*, 68–69. The untied capital can then be put to other profitable uses in the meantime. While warrants are high-risk instruments they can be combined in a suitable portfolio to offer an acceptable degree of risk for some trusts.

22. Zeros are a class of share purchased from split investment trust companies. The companies hold a single investment portfolio designed to produce both income and capital growth but the shares it issues are divided into income and capital. Holders of income shares receive all of the income, paid as dividends throughout the duration of the company, and are repaid the issue price of the shares on a fixed redemption date. Holders of capital shares receive no income but get their return from the trust capital at the redemption date.

23. Capital growth shares, for example, receive all of the capital that remains at the redemption date after all other classes of share have been paid. The return from these shares is often heavily dependent on gearing; hence offer much greater risk than other share classes but potentially far greater returns.

24. The capital only investments discussed above are illustrative only. Numerous other examples could be added. For example, the purchase of short-dated stock giving a capital yield on redemption but no income may be a suitable trust investment for many trusts. For larger trusts involvement in the trading of commodities may provide the opportunity for better returns at a given level of risk, particularly when part of a suitably diversified portfolio. Even chattels, such as antiques and paintings, are now purchased as investments by some institutions because of their capacity to produce a capital return upon resale.

24a See the discussion of *Marson (Inspector of Taxes) v Morton*, *infra*.

context of trust investment law, the courts have historically shown a willingness to develop the meaning of words and concepts in line with changing social and economic conditions. For example, at the turn of the last century the Court of Appeal²⁵ extended the meaning of 'securities' in line with its then current commercial usage, despite it already having a well-defined primary legal meaning of 'money secured on property',²⁶ to include stocks and shares in companies. Vaughn-Williams LJ analogised:

'Fifty years ago the word "electricity" had a primary meaning: Are we to follow that meaning now, notwithstanding that it has been extended by modern scientific discovery?'²⁷

More recently, Dillon LJ has made similar observations in discussing the 'prudent man of business' standard. He cautioned:

'what the prudent man should do at any time depends on the economic and financial conditions at that time – not on what judges of the past, however eminent, have held to be the prudent course in the conditions of 50 or 100 years before.'²⁸

The meaning of investment has been recently conceived in such evolutionary terms, albeit not in the context of trust law. The changing jurisprudence in tax cases provides the most obvious, if little noticed, illustration of this trend. Traditionally, when considering the meaning of investment, courts hearing tax cases emphasised the importance of income.²⁹ More recently, however, this approach has been rejected. Thus, in *Marson (Inspector of Taxes) v Morton*³⁰ the issue arose whether the purchase and resale of freehold land purely for capital gain was an 'investment' or a 'trading transaction'. Browne-Wilkinson V-C, as he then was, commented:

'[I]n my judgment in 1986 it is not any longer self-evident that unless land is producing income it cannot be an investment. The legal principle cannot change with the passage of time: but life does. Since the arrival of inflation and high rates of tax on income new approaches to investment have emerged putting the emphasis in investment on the making of capital profit at the expense of income yield. For example, the purchase of short-dated stocks giving a capital yield on redemption but no income has become commonplace. Similarly, split-level investment trusts have been invented which produce capital profits on one type of share and income on another. Again, institutions now purchase works of art by way of investment ... I can see no reason why land should be any different and the mere fact

25. In *re Rayner*, *Rayner v Rayner* [1904] 1 Ch 176.

26. See, for example, *Hudleston v Gouldsbury* (1847) 10 Beav 547 (canal shares could not pass under bequest of 'bonds or other securities'); *Harris v Harris* (1861) 29 Beav 107 (power to invest 'upon the security of any company incorporated by Act of Parliament' did not permit investment in railway preference shares); *Re Mason's Will* (1865) 34 Beav 494, 498–499 (unsecured debts and shares in companies not securities). Such cases reflect the then general prevailing attitude that it would be 'highly dangerous' to depart from the 'definite legal meaning' of investment: *Re Kavanagh, Murphy v Royale* (1891) 27 LR Ir 495, 498 per Porter MR.

27. *Supra* n 25, 182. See also at 185: 'The word is not a term of art, but only a word of description. It is a commercial word which will vary with the history of commerce'. Similar sentiments were expressed earlier in *Re Johnson, Greenwood v Greenwood* (1903) 47 Sol Jo 547, 547 per Kekewich J, affirmed on appeal (1903) 89 LT 520.

28. *Nestle v National Westminster Bank* [1994] 1 All ER 118, 126.

29. *Tootal Broadhurst Lee Co Ltd v. Inland Revenue Commissioners* [1949] 1 All ER 261, 265 per Lord Normand; *IRC v Reinhold* (1953) 34 TC 389; *Johnston (Inspector of Taxes) v Heath* [1970] 1 WLR 1567 (purchase and immediate resale of land not an investment because it was not purchased for the purpose of income production).

30. [1986] 1 WLR 1343.

that land is not income producing should not be decisive or even virtually decisive on the question whether it was bought as an investment'.³¹

In tax cases the meaning of investment has therefore evolved to maintain congruence with contemporary investment practices. Absent special considerations, it is only logical for trust law to follow suit.³² Indeed, this would merely represent the continuation of a historical trend. During the formative period of trust law the term 'invest' was initially restrictively construed as a loan.³³ *Re Power* itself, therefore, represents just one point in an evolving meaning of investment.

The fears of an expanded meaning of 'investment'

Why is it that a restrictive meaning of investment focused on income found its way into the conscience of trust lawyers? Two reasons appear to have operated historically that set trust cases apart from other contexts: the emphasis on the preservation of the trust fund and the duty of the trustee to treat competing beneficiaries with an even hand. Neither of these reasons justifies the restrictive meaning of investment in contemporary trust law, however.

Preservation of the trust fund

Traditionally the courts have placed a premium on the preservation of the trust fund.³⁴ Any investment with a fluctuating capital value was viewed with some scepticism, hence the bar on trustees investing in shares in the absence of clear express authorisation.³⁵ Assets that not only produced no income but whose only chance of financial gain came from a positive movement in the fluctuating capital were therefore likely to be viewed as unduly speculative. Indeed, even recently it has been suggested that the purchase of assets solely for capital appreciation are not trustee investments because their value 'is a matter of chance, or even fashion, when considering art'.³⁶ The definition of 'investment' in the trust law context, it might be argued, therefore acts as a gatekeeper to a class of inappropriate investments.³⁷ This argument is, however, inconsistent with modern developments in investment and financial theory for three reasons.

31. Ibid, 1350. See also *Grimwood-Taylor v Inland Revenue Commissioners* [2000] STC 39; *Cook (Inspector of Taxes) v Medway Housing Society Ltd* (1997) 69 TC 319.

32. Recent *obiter* in trust cases are consistent with this understanding: see *Harries v Church Commissioners for England* [1993] 2 All ER 300, 304 per Nicholls VC, stating that where property is 'held by trustees as an investment ... prima facie the purpose of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence'.

33. Hayton, *supra* n 4, p 592.

34. See *In re Somerset, Somerset v Earl Poulett* [1894] 1 Ch 231, 247 per Kekewich J, suggesting that a trust investment should 'not only during the period yield the stipulated income, but will ultimately and whenever required, realise the full sum advanced'.

35. See *In re Sir SM Maryon-Wilson's Estate* [1912] 1 Ch 55, 66–67 per Farwell LJ, stating 'investment clauses purporting to add to the wide range of investments now authorised by law should be construed strictly for the protection of trustees and remaindermen; if a greater latitude is to be allowed, testators and settlors should express its extent in clear terms'. See now, however, *Re Harari's Settlement Trusts, Wordsworth v Fanshawe* [1949] 1 All ER 430.

36. Charity Commission, *Operational Guidance: Trustee Act 2000, General Power of Investment* (OG Int 28 B1 – 1 February 2001).

37. Historically, 'investment' was often used in contradistinction to 'speculation': see the submission of counsel in *Rayner*, *supra* n 25, 182. Hence, as a class of assets that were seen as speculative, purchases solely for capital appreciation were not deemed to be investments.

First, not all assets purchased for capital appreciation carry with them an imprudent degree of risk. Indeed, in some instances the degree of risk from such assets is prudent for even relatively small family trusts. Returns from zero dividend preference shares, for example, are comparable to, if not better than, most unit trusts, and all of the zeros that have matured to date have paid out as expected.

Second, modern financial theory³⁸ dictates that the appropriateness of specific investments or techniques, including those that are abstractly risky, should not be judged in isolation but in terms of the role they play in overall portfolio strategy.³⁹ An otherwise volatile non-income producing investment, such as a put option, may in fact significantly enhance a portfolio by reducing overall risk and increasing expected returns. This will occur if factors affecting its own return tend not to correlate with the factors affecting the returns of other investments in the portfolio. As a result the portfolio's overall risk will be less than the weighted average of the risk of the individual investments contained therein.⁴⁰

Third, understandings of risk are meaningless without context. Modern financial theory teaches us that returns from investments vary positively with risk. There is, however, no generally applicable level of acceptable risk. Individual trusts have such diverse purposes that the setting of a universal standard of risk for trust portfolios would be inefficient. For those trusts that can tolerate added risk, a higher risk investment strategy may be appropriate given the potential for greater returns.⁴¹ A trustee's task is to identify the level of risk appropriate to the particular trust and construct a portfolio that offers the maximum return for that level of risk. Thus, in *Trustees of the British Museum v Attorney General Megarry VC* said:

'The object of the trust may be very material. In the present case, the desirability of having an increase of capital value which will make possible the purchase of desirable acquisitions for the museum despite soaring prices does something to justify the greater risks whereby capital appreciation may be obtained'.⁴²

The duty to maintain an even hand between beneficiaries

The restrictive definition of investment has also been conditioned by a concern to ensure that trustees comply with their duty of even-handedness between life beneficiaries and those entitled in remainder. Historically, trustees were under a duty to preserve the nominal value of the trust fund for the remaindermen while assuring a steady, if conservative, income for the life tenants.⁴³

-
38. Trustees are now entitled to be judged according to modern portfolio theory: *Nestle v National Westminster Bank PLC*, Unreported 29 June 1988 (Hoffmann J), reprinted (1996) 10 TLI 112; Lord Nicholls, 'Trustees and Their Broader Community: When Duty, Morality and Ethics Converge' (1995) 9 TLI 71, 76. There remains little writing in the English jurisdiction on the application of modern portfolio theory to trust investment selection. Stimulated by the Uniform Prudent Investor Act (1994) and *Restatement (Third) of the Law of Trusts* (1992) there is a dearth of detailed literature on the subject in the US. Of the more noteworthy, see Begleiter, 'Does the Prudent Investor Need the Uniform Prudent Investor Act - An Empirical Study of Trust Investment Practice' (1999) 51 Me L Rev 27; Langbein, *supra* n 20; Halbach, 'Trust Investment Law in the Third Restatement' (1992) 77 Iowa L Rev 1151; Haskell, 'The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory' (1990) 69 NCL Rev 87; Gordon, 'The Puzzling Persistence of the Constrained Prudent Man Rule' (1987) 62 NYUL Rev 52.
39. Contrast the historical position taken in *Re Whitely* (1887) 12 App Cas 727, 733 per Lord Watson: it is the duty of a trustee to 'avoid all investments...which are attended with hazard' (emphasis added).
40. For detailed discussion see Langbein, *supra* n 20, 646-649; Levy, *supra* n 20, 12-19.
41. There is little treatment of risk-return analysis in English law. For a detailed analysis see American Law Institute, *Restatement (Third) of the Law of Trusts* (1992) §227, comment e.
42. [1984] 1 All ER 337, 343.
43. *Speight v Gaunt* (1883) 22 Ch D 727, 750 per Cotton LJ, 753-754 per Jessel MR; *supra* n 28, 139 per Leggatt LJ.

A definition of investment emphasising income yield was consistent with this duty since it limited trustees to the purchase of those assets that by their very nature were most likely to embody such an acceptable balance. This reasoning is, however, inappropriate in light of modern investment conditions and increasingly sophisticated financial theory, although it still retains support in a leading text.⁴⁴

During times of chronic inflation a mandate to preserve the nominal value of the estate may well defeat the settlor's objectives of transferring wealth to the remainder,⁴⁵ as well as adversely affecting the income producing capacity of the fund over the long term.⁴⁶ An increased emphasis on capital growth is, therefore, required in contemporary economic conditions to preserve the real value of the trust fund and maintain its capacity to produce a constant real income. Furthermore, modern portfolio theory judges the prudence of investments by reference to the total return (income and capital gain/loss) of the whole portfolio.⁴⁷ The duty of even-handedness must be similarly understood at this portfolio level. Trustees are required to determine the desired balance between capital growth and income and construct a portfolio that is suitably balanced taken as a whole. The duty of even-handedness can be thus maintained so long as the purchase of assets for capital growth are appropriately balanced by the purchase of other assets emphasising income yield. A complete bar on capital only investments is not required and only serves to place out of bounds what are otherwise potentially appropriate trust investments.

In contrast to the position during the formative period of trust investment law, today there also exists a majority of trusts that do not provide for successive interests, hence do not require a balance between income yield and capital appreciation. For example, a trust may provide for the accumulation of income with a view to conferring on the beneficiary a lump sum at a fixed future date. In such an instance it is the overall financial performance of the fund that is important, not whether the return comes from income or capital. Indeed, the purpose and circumstances of some trusts may dictate that capital growth is to assume a *greater* importance than income yield.⁴⁸

Consideration of fund preservation and even-handedness between beneficiaries are not compelling reasons for the maintenance of a restrictive meaning of investment in the trust law context. Assets purchased for the purpose of capital appreciation or hedging may prove invaluable to trusts and provide trustees with more effective means by which to further the purpose of their trusts. As with most investments, they do possess the potential to cause loss or unfairly favour one class of beneficiaries over another if used inappropriately. However, separate legal duties exist to ensure that imprudent and speculative investments are not made⁴⁹ and that trustees maintain an even hand between beneficiaries.⁵⁰ The meaning of investment as a gatekeeper against a class of inappropriate investments is a rather crude and inappropriate substitute for these flexible duties.

44. Martin, *supra* n 4, 514.

45. Historically inflation was non-existent over the long term as periods of inflation were offset by periods of deflation: see the observations of Staughton LJ in *Nestle v National Westminster Bank*, *supra* n 28, 134. Even a stable low rate of inflation can prove disastrous to a remainder beneficiary. For example, if the annual rate of inflation remained at just 2 per cent for the next 20 years and a trust fund merely retained its nominal value, a fund valued at £10,000 in 2001 would be worth, in real terms, just £6,730 in 2021.

46. For a particularly graphic illustration of this, see *Re Mulligan* (deceased) [1998] 1 NZLR 481, 490.

47. *Supra* n 32, 304 per Nicholls VC; *Cowan v Scargill* [1984] 2 All ER 750, 760 per Megarry VC.

48. *Supra* n 42, 343 per Megarry VC.

49. *Supra* n 3, paragraphs 2.30–2.38, considering mechanisms for protection of beneficiaries.

50. Hayton, *supra* n 4, pp 500–517.

The policy underlying the Trustee Act 2000

The meaning of words must be interpreted in a manner consistent with their purpose.⁵¹ The use of the term 'investment' in the TA 2000 is no different. Consideration of the underlying purpose of the TA 2000 makes clear that the meaning of investment is to be interpreted in a manner consistent with modern commercial investment practice rather than its historical usage.

The TA 2000 is partially a response to widely expressed discontent with the TIA 1961.⁵² Effective investment was regularly frustrated by the TIA, the structure of which often prevented trustees from making investments that were in the best financial interests of the trust because of the 'legal list' approach of the Act.⁵³ Since the Act's list of prescribed investments remained relatively static as investments evolved,⁵⁴ trustees were often unable to take advantage of opportunities brought about by the rapid rate of investment innovation. Any reform was, therefore, required to not only reflect and accommodate currently accepted investment practices of the financial community but, as far as possible, retain sufficient flexibility to permit the prudent use of any future investment innovation.⁵⁵ Section 3 of the TA 2000, in abrogating categorical restrictions in favour of a general power of investment, was intended to achieve this.

A static, traditional meaning of investment would, however, partially frustrate these aims by arbitrarily restricting the range of assets available to trustees as investments. Not only would trustees be prevented from taking advantage of a number of existing investment opportunities, they would also be prevented from taking advantage of any future innovative investments that did not produce income but were nevertheless financially beneficial to the trust for other reasons. Indeed, a restrictive meaning of investment would merely perpetuate via the back door the very evil that the TA 2000 sought to avoid, namely a form of categorical restriction. By contrast, a broad and flexible meaning of 'investment' that is capable of moving with investment practices will permit trustees to take advantage of innovative investment products and techniques in so far as they are consistent with prudent trusteeship. An evolving meaning of investment that shifts in line with commonly accepted investment practices will, therefore, best further the policy of the TA 2000 by allowing trustees to concentrate on securing the highest financial return for the particular level of risk that is appropriate to the trust.

Conclusion

A number of modern investments are potentially invaluable in the management of trust funds, notwithstanding that they yield no income. In order to allow trust funds to be managed in the best financial interests of beneficiaries the meaning of investment has evolved in line with these

-
51. See, for example, the consideration of the word 'invested' contained in s 39 of the Life Assurance Act 1945 in *Melville v Mutual Life and Citizens Assurance Co Ltd* (1980) 31 ALR 649. The court was faced with two commonly accepted legal meanings of 'invested': the 'broad commercial sense', meaning the laying out of money for some commercial purpose; and the narrower sense of the laying out of money for the purpose of obtaining income or other pecuniary gain. The latter meaning was applied on the basis that, while the term could give rise to either meaning, in the instant case it was more consistent with the purpose of the legislation.
52. See *Investment Powers of Trustees: A Consultation Document* by HM Treasury (May 1996); *supra* n 3, paragraphs 2.16–2.18.
53. *Supra* n 3, paragraphs 1.17, 2.2; *supra* n 42, 340–341.
54. The powers of investment conferred by the 1961 Act could be extended by adding to the prescribed list of authorised investments in Schedule 1, Parts I–III, any manner of investment specified by Order in Council: TIA 1961, s 12(1). However, even where this power was exercised there was necessarily a time lag between the general acceptance of an investment and its addition to the legal list.
55. See the comments of Lords Irvine and Goodhart, *Hansard*, HL Vol 612 Cols 373 and 381–382 (2R, 14 April 2000).

changes. This view is strongly supported by judicial developments in other areas of law and the external context of the TA 2000. In pursuit of their investment functions trustees are, therefore, permitted to purchase any asset currently accepted for investment purposes by the financial community. Accordingly, trust investments at present include assets purchased for the purpose of income yield, capital appreciation or the furtherance of risk management. These classes of investment are not closed, however, and the meaning of investment will evolve in line with future innovation. Understanding investment as such ensures that trustees will continue to be free to pursue rewarding investment strategies in accordance with best current practice and without arbitrary restriction.

Andrew D Hicks
Lecturer in Law, University of Hull