REPORT OF THE
WILLS, TRUSTS AND ESTATES SECTION OF
THE VIRGINIA BAR ASSOCIATION AND
THE VIRGINIA BANKERS ASSOCIATION ON

Fiduciary Investments

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

HOUSE DOCUMENT NO. 40

COMMONWEALTH OF VIRGINIA
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REPORT OF THE WILLS, TRUSTS AND ESTATES SECTION OF THE VIRGINIA BAR ASSOCIATION AND THE VIRGINIA BANKERS ASSOCIATION TO THE GOVERNOR AND GENERAL ASSEMBLY OF VIRGINIA

RICHMOND, VIRGINIA

DECEMBER 1991

To: The Honorable L. Douglas Wilder, Governor of Virginia

and

The General Assembly of Virginia

INTRODUCTION and BACKGROUND

Pursuant to House Joint Resolution 395 sponsored by the Honorable Gladys B. Keating, the General Assembly at its 1991 Regular Session requested the Wills, Trusts and Estates Section of the Virginia Bar Association (the "Section") and the Virginia Bankers Association to study the status of Virginia's lawful fiduciary investments. The groups were asked to recommend amendments, deletions and additions and to make other recommendations as deemed appropriate. A copy of the Resolution is attached as Exhibit "A". Virginia's list of lawful fiduciary investments (generally known as the "legal list") is found at Virginia Code § 26-40. A copy of the current statute is attached as Exhibit "B".

Previously, in 1990, the Section had appointed a subcommittee to study possible changes to Virginia's current prudent man rule, Virginia Code § 26-45.1 (Exhibit "C"), and had asked

the Virginia Society of Certified Public Accountants and the Virginia Bankers Association to take part in the project. Although House Joint Resolution 395 refers only to "other recommendations as deemed appropriate", the Committee ultimately constituted by the Section and the Bankers Association (the "Committee") was advised by Delegate W. Tayloe Murphy, Jr., an original co-patron of the Resolution, that this reference was intended to extend the area of the Committee's study to include the prudent man rule if the Committee should think it appropriate.

The Virginia Bankers Association appointed its representatives in the Spring of 1991. By that time, the Virginia Society of Certified Public Accountants had appointed Mark T. Nash, CPA, of Richmond to take part in the study originally contemplated by the Bar Association. The Committee acknowledged that House Joint Resolution 395 made no reference to accountancy but asked Mr. Nash to sit with them during their deliberations. He kindly did so.

As finally constituted, the Committee appointed pursuant to Delegate Keating's resolution consisted of seven lawyers, Michael Armstrong, Richmond; James G. Arthur, Arlington; Dennis I. Belcher, Richmond; R. Hart Lee, Richmond; Linda F. Rigsby, Richmond; J. Hume Taylor, Jr., Norfolk; and Harry J. Warthen, III, Richmond; and three bankers, Thomas A. Davis, Staunton; Mrs. Becky T. Kelly, Richmond; and Joseph E. Machatton, McLean. Mr. Warthen served as Chairman.

The Committee held its meetings in Richmond beginning in late July. General advice concerning drafting techniques and the preparation of the Committee report was kindly provided by Mary Devine, Esq., of the Division of Legislative Services. The Committee also had the advice of investment officers from Crestar and Sovran Banks and from counsel for the Virginia Bankers Association. In addition, helpful suggestions were received from Thomas S. Word, Jr., of the Richmond Bar.

SUMMARY

Following its review of Virginia law and current investment philosophy and fiduciary practice, the Committee makes the following findings and recommendations.

1. Notwithstanding certain negative aspects of a legal list (most notably in a period of protracted inflation), the Committee concludes that a legal list of investments is potentially helpful in certain situations in providing safe investments for the fiduciary who wishes protection for himself and maintenance of principal for the beneficiary. The Committee also believes, however, that the legal list in many cases no longer represents absolutely safe investments and, in addition, in large part is not helpful to many fiduciaries in view of the statute's many conditions and restrictions defining the availability of particular types of investments. Thus, the Committee proposes a revised legal list the guiding principles of

which are a renewed emphasis on safety of principal and ease of use. The proposed revised list appears as Exhibit "D".

2. The Committee concludes that Virginia's prudent man rule has failed to keep pace with developments in investments and finance, unnecessarily discourages investment specifically designed to fit the needs of particular beneficiaries, and should be revised in the best interest of the people of the Commonwealth. The suggested revisions include (1) the removal of the "anti-netting" rule, (2) a stated duty to diversify and to review investments as a part of the investment portfolio as a whole, and (3) an obligation to take the interests of all beneficiaries into account in making investment decisions. The proposed changes are generally in line with what has come to be called the prudent investor rule. The proposed revised statute appears as Exhibit "E".

FINDINGS AND RECOMMENDATIONS

I. Legal List (§ 26-40)

Continuing Need and Inherent Problems - The Committee discussed at length both the continuing need for a legal list and what such a list should contain. The debate concerning the continued need for a legal list focused on the tension between the post-World War II inflationary economy and the purpose of such a list - to establish a protected area for fiduciary investments to the benefit of both the fiduciary (who is protected from

surcharge through investing in accord with the list) and the beneficiary (who, in theory, is protected against a decline in the value of the principal account through the safety of the investments contained in the list). If, however, a fiduciary restricts investments to the current legal list, there will be little chance of real growth in the principal account. Investment pursuant to the legal list likely will provide a ready flow of income to the income beneficiary while providing protection (although possibly imperfect protection, depending largely upon interest rate fluctuations) in the absolute value of the principal account. It almost certainly will not provide an increase in the principal account sufficient to maintain the purchasing power of the account for the remainder beneficiary in the case of the typical trust or for the income beneficiary himself (for example, in the case of a guardianship). Nevertheless, the fiduciary enjoys the assurance that no claim can be made against him for lack of investment success so long as he invests in accord with the statute.

Thus, the protection provided by the statute in the post-World War II inflationary economy is largely protection for the fiduciary alone. The corresponding investment protection for the ultimate taker of the principal account - the other part of the theoretical equation - disappears over time as inflation reduces the value of the dollar.

In addition, it was suggested that the existence of a legal list encourages what, for want of a better term were called

middle level fiduciaries (who are neither professional fiduciaries nor family members, such as the guardian of an infant or an incapacitated person) to enter into fiduciary relationships for which they are not qualified in anticipation that they may invest simply pursuant to the legal list. It thus was thought that the repeal of the legal list would work to the advantage of the public in that it would discourage willingness on the part of certain persons to undertake responsibilities for which they are not qualified.

The Committee also noted that the existence of a legal list provides a ready basis for questioning the performance of asset managers who endeavor to invest with an eye to growth as well as income but who are unsuccessful in their efforts. The existence of a ready measuring device in the form of a legal list may be seen as a hinderance to true investment by individuals not willing to assume investment risks in the face of such an easy comparison of what might have been had no attempt at true investment been made.

On the other hand, the Committee acknowledged that the legal list is helpful in certain cases. The example most frequently used was the case of an infant or incapacitated person with modest assets who requires the services of a guardian. In such a case, family assistance would likely be more forthcoming if family members or others knew that they could invest funds pursuant to a protected list and that it would not be necessary for them to put the account and themselves at risk in the

investment market. On balance, the Committee concluded that this possibility was reason in itself to suggest revisions to, and not the repeal of, § 26-40[1/]

Suggested Changes: Primary Points - Concluding that the legal list provides a service in certain cases, the Committee assessed its continued effectiveness in providing maximum safety of investment for the beneficiary and ease and convenience of use for the fiduciary. The Committee concluded that the present statute, which has been amended many times over the years and now covers approximately nine pages of the Virginia Code, does not provide, in today's investment climate, the safety for the beneficiary that it is intended to provide. In addition, it contains numerous conditions and tests in the case of particular proposed investments that in many cases are difficult of ready determination. The Committee then discussed possible ways in which to bring the statute current and to make it more "user friendly".

1/ Banker members of the Committee were unanimous in the view that the continued existence of the legal list is irrelevant to Virginia trust business. Committee member Mrs. Becky Kelly, an officer with Sovran Bank's Trust Department, advised of a review of all trust accounts within the Sovran system that revealed, among the thousands of various accounts managed by that bank, only forty-six in which the controlling document made reference to the legal list. No Virginia bank voluntarily uses this list as its own fiduciary investment guide.

The Committee conducted an informal canvass of the other states and received responses from forty-four. Of this number, twenty-six have no legal list. Even fewer have both a statutory prudent man rule and a legal list. Five have revoked earlier lists, presumably on the theory that the prudent man rule is sufficient.

Investment officers who met with the Committee were of the view that a revised statute should provide general guidance and not list specific assets. They advised that it would not be productive to examine the considerable number of investments currently found in the legal list on an item-by-item basis. As a result, no such attempt was made.

The Committee's proposed revisions to the legal list (Exhibit "D") reflect two basic decisions. First, while acknowledging the inherent tension between an investment that is safe and one that can reasonably be expected to keep pace with inflation, the Committee concluded that equity investments are inconsistent with the notion of absolute safety of principal. Thus, the suggested revision includes no equity securities. Second, the Committee sought an objective measure for fiduciary investments in state issues that would be both readily available and easy to use. Taking note of the rating system found at Virginia Code § 2.1-328.1 (Investment of Public Funds), the Committee suggests a system based upon the ratings of Standard and Poors Corporation, Moody's Investor Service, Inc., and Fitch Investor Service, Inc. The Committee submits that the resulting suggested statute provides overall a greater level of safety of principal than that found in the present legal list and also, in the case of obligations of the Commonwealth, its agencies and political subdivisions, a readily usable rating system by which to measure proposed investments.

The proposed revised legal list is limited to (1) obligations of the Commonwealth, its agencies and authorities and other public bodies in the Commonwealth; (2) obligations of the United States; and (3) savings accounts, time deposits or certificates of deposit to the extent of federal insurance. Virginia obligations must be rated in one of the two highest rating categories of at least one of the three national rating services and may not be rated in a category lower than the two highest categories by any rating service. In addition, in an effort to reduce market risk through fluctuation in interest rates, remaining maturity may not exceed five years. Obligations of the United States (other than savings bonds) and securities unconditionally guaranteed by the United States likewise may not exceed five years to maturity. Federal government issues may be held in the form of securities of an investment company or investment trust.

Suggested Changes: Smaller Points - Several additional points should be noted. First, the Committee suggests that the potential protection of the legal list be extended to attorneys-in-fact or other agents acting for principals under written powers-of-attorney and to their principals. Present Virginia law does not address investment by this increasingly important type of fiduciary.

Second, since the Committee's suggestions substantially narrow the current list, the final paragraph of suggested § 26-40.01 provides that the continued retention of investments listed

in the current statute that are not found in the suggested revision but which continue to be held on July 1, 1992 is to be judged by the rule of revised § 26-45.1. Likewise, any reference to the "legal list" or to § 26-40 (or any of its predecessors) contained in an instrument that is irrevocable on June 30, 1992 is to be construed to be a reference to such section as in effect on that date (or as in effect at such earlier time as may be specified in the controlling document (trust agreement, etc.)), absent an expression of contrary intent in the document.

Finally, present Virginia Code § 26-44 provides that investments made under the provisions of § 26-40 may be retained even though they may cease to be eligible for purchase "unless the exercise of reasonable care requires the sale or other disposition of such investments". The Committee suggests that this provision would be equally applicable under its proposed revisions but suggests that the "reasonable care" test be revised and that the continued retention of investments that become ineligible for purchase be measured by the revised rule of § 26-45.1 (Exhibit "E"). Counsel for the Virginia Bankers Association noted that the "reasonable care" test arguably would provide a different standard from that found in § 26-45.1 and suggested that there should be only one test. The Committee concurred.

Effect on State Agencies and Banking Institutions - The present legal list is of interest to state agencies for two reasons. First, the list, in whole or in part, is the statutory investment guide for several state agencies and governmental

activities as well as for certain trust banking activities through a number of statutory cross-references. The statutes that refer to the legal list and the activities to which they relate are:

§ 2.1-328 (Investment of Public Funds)

§ 5.1-88.2 (Financial Responsibility Relative to Aircraft)

§ 6.1-21 (Security for Commercial Bank Trust Department Funds)

§ 6.1-195.86 (Security for Savings & Loan Trust Department Funds)

§ 36-55.44 (Housing Development Authority Deposits)

§ 51.1-803 (Investment by Local Retirement Systems)

§ 54.1-1119 (Virginia Contractor Transaction Recovery Act)

§ 54.1-2113 (Virginia Real Estate Transaction Recovery Act)

§ 62.1-221 (Virginia Resources Authority)

The Committee has made contact with a representative of each entity affected. The Executive Directors of the Housing Development Authority and the Resources Authority wish to continue with the more flexible current investment rules. Likewise, the State Treasurer so advised as to the investment of public funds and local retirement systems. Spokesmen for the Director of the Department of Aviation and on the Board of Contractors and Real Estate Board are willing to proceed

under the proposed changes. The Virginia Bankers Association has advised that its members with trust departments are willing to proceed under the proposed changes. The Virginia League of Savings Institutions has advised that none of its members currently exercises trust powers and that the change is acceptable to them. The proposed bill will include legislation necessary to maintain the present status of those entities wishing to continue under current law and will make the proposed changes applicable to those entities willing to make the change.

Second, the present legal list includes all issues by any "county, city, town, district, authority or other body in the Commonwealth". In addition, a number of statutes creating, or authorizing the creation of, public bodies within the Commonwealth provides that bonds issued by the public body shall be legal investments for fiduciaries. The Committee is aware that the tests set out in its proposed revised list will result in the removal of those issues that do not meet the proposed standards. However, subsection C of the proposed list provides that any investments listed in present § 26-40 and on hand on July 1, 1992 may be retained if the fiduciary believes them to meet the test of prudency set out in proposed revised § 26-45.1. In addition, any such issues that the fiduciary deems prudent as measured by that section may be acquired in the future. The Committee's recommendations are not a bar to fiduciary investment in such issues.

II. Prudent Man Rule (§ 26-45.1)

Current Virginia Law - As noted above, Virginia is among those jurisdictions that have both a legal list and a prudent man rule of fiduciary investment. Like many American jurisdictions, Virginia has codified its prudent man rule (Exhibit "C"). In Virginia as elsewhere, the prudent man rule places emphasis on the maintenance of capital and the production of income: fiduciaries are to invest "not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital". Va. Code § 26-45.1. Traditionally, speculative investments have been judged imprudent per se under the prudent man rule. As a result, care and professional skill in selection and appropriateness to a particular situation are no defense if an investment is judged to be speculative (e.g., venture capital programs, oil and gas, etc.). In addition, the anti-netting rule, which prohibits a trustee from defending his investments by "netting" losses through improper investments against profitable proper investments, is a corollary to the prudent man rule's principle that each separate investment be tested separately for its appropriateness.

Modern investment theory has moved to what is called the "portfolio theory of investment" in which the investor reviews his portfolio as a whole and judges risk and potential reward based upon the entire account and not within the isolation of each separate investment viewed independently of the others.

This concept as the basic investment technique is at odds with the prudent man rule which examines each asset in isolation. To a considerable extent, there is reason to believe current fiduciary practice is in line with modern investment theory and the best interests of beneficiaries, but it is not in accord with Virginia's present prudent man rule. To the extent Virginia fiduciaries are operating under documents that do not permit or direct the use of such techniques, however, they do so without protection for themselves.

The Committee believes that in the modern investment climate restrictions on investments per se are not warranted in many cases. Circumstances present in a particular situation can permit, indeed perhaps encourage, investments that would not be permitted under the classic prudent man rule. An article in the April 29, 1991 Business Section of the Richmond News Leader discussed the Virginia Retirement System's decision to allocate $100,000,000 for investment in the futures market.[3/] Although the V.R.S. handles billions of dollars and invests for different purposes, the same investment considerations in other contexts could lead private beneficiaries and their trustees to similar investment conclusions. Depending upon the circumstances of particular beneficiaries, a Virginia trustee might think it in the interest of his beneficiaries to invest in a venture capital situation, in undeveloped real estate or in oil and gas programs,

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3/ The Wall Street Journal for November 5 carried a similar article discussing such decisions by other state retirement systems.

all of which would be questionable under the current prudent man rule. Such investments might be appropriate in only a small number of cases but all would be subject to question under current Virginia law notwithstanding the wishes of the beneficiaries involved. To the extent such investments are now being made in situations that do not involve a waiver of the prudent man rule, Virginia trustees are addressing the best interests of their beneficiaries as they see them but without legal protection for themselves.

In brief, the Committee concludes that the present Virginia rules are inconsistent with investment flexibility and a fiduciary's obligation to avail his beneficiaries of the best of current investment thinking and strategy. Virginia beneficiaries and their trustees would benefit from rules with sufficient flexibility to permit response to changes in the financial world within the context of a particular family's particular circumstances. Not only is this flexibility not available under current law but Virginia's current prudent man rule, if followed by the fiduciary, actually stands in the way of a fiduciary's full utilization of his knowledge and skills to what the Committee believes to be the detriment of Virginia beneficiaries and trustees alike.

Suggested Changes - Exhibit "E" sets out the Committee's proposed revisions to the Virginia prudent man rule. The more important changes are discussed below.

First, the proposed statute makes clear that the fiduciary is to exercise his judgment under the circumstances prevailing from time to time including general economic conditions, anticipated tax consequences, the duties of the fiduciary and the interests of all beneficiaries. No such suggested considerations are found in the present statute. The change is intended to emphasize that the fiduciary should take into account in investment decisions, not only large considerations such as general economic conditions, but also the interests of both income and remainder beneficiaries.

Second, the proposed changes are intended to make clear that these considerations are to be taken into account within the context of accomplishing the purposes set forth in the controlling document. The change is intended to remind the fiduciary that investment policies are to be tailored to the accomplishment of the purposes set forth by the testator or trust grantor. Investment decisions, like decisions concerning distribution or accumulation of income, are to be designed to further the overall objectives of the trust. What may be a prudent investment within one particular family context may be inappropriate in another.

Third, the fiduciary is specifically directed to consider individual investments within the context of the portfolio as a whole. As discussed above, this revision represents a considerable departure from the present rule which, theoretically requires that each investment be reviewed separate and apart from other investments in the account. The rule is intended to empha-

size that the risk of an individual investment is to be assessed, not just in relation to its anticipated reward, but also within the overall allocation of assets and risk balancing within the account.

Fourth, the proposed statute expressly states that a fiduciary has a duty to diversify investments unless, for particular reasons under particular circumstances, it is prudent not to do so. The prudent man rule, which examines the appropriateness of each asset separately, does not require diversification. The importance of a stated presumption of diversification was emphasized by an example of recent Virginia litigation concerning a fiduciary account established in the 1930s with two securities having a value of $50,000. The trust was distributed in the mid-1980s to its remainder beneficiaries with a closing value of approximately $53,000. The two stocks that entered the account originally were not traded and were distributed in kind at trust termination. The trust remaindermen attempted to surcharge the fiduciary for $1,000,000, the hypothetical value of the account determined in accord with various stock indices covering the entire period. The fiduciary defended on the basis that Virginia law does not recognize loss through inflation and that the beneficiary, on a case-by-case analysis (a simple matter with only two stock holdings), had suffered no financial loss. The litigation was settled for approximately $10,000. This result would not be possible under the Committee's proposal with its emphasis on diversification and the interests of all beneficiaries.

Fifth, it is suggested that subsection (e) which permits the waiver of the prudent man rule by a grantor or testator be broadened to permit an express authorization to acquire or retain a specific type of asset, such as a closely held business. It was brought to the Committee's attention that a fiduciary, in view of the omission of such a provision from the present statute, would retain a specific asset that could be characterized as speculative only at his peril. The suggested change addresses an admittedly rare situation but one which the Committee felt should be addressed.

Finally, the Committee suggests it be made clear that the prudent man rule applies to investments by attorneys-in-fact. As noted earlier, present Virginia law currently does not address investments by this type of fiduciary.

The Committee notes that several aspects of its proposed § 26-45.1 are found already in a related area of Virginia law. The Management of Institutional Funds Act (Virginia Code §§ 55-268.1 through 268.10) contains its own standard of conduct at § 55-268.6. This standard directs members of a governing board in their decisions concerning investments to take into account "circumstances prevailing at the time of the action or decision, and in so doing they shall consider long- and short-term needs of the institution, in carrying out its . . . purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions".

The Committee also notes that its proposed changes are in line with current developments in this area of American law. The American Law Institute's revisions in its Restatement of the Law of Trusts, Third, which will contain the principles discussed in this Report, is currently in the process of publication. The National Conference of Commissioners on Uniform State Laws shortly will undertake a suggested codification of the Restatement's new principles. Other states, most recently Illinois, are modifying their statutes along the lines of the Committee's suggestions. See Welch "How the Prudent Investor Rule May Affect Trustees", Trusts & Estates, December 1991.

III. Conclusion

For the reasons outlined above, the Committee recommends a total revision of Virginia's legal list (Virginia Code § 26-40) in order to increase investment safety and to make the list more readily usable by the individual consumer. The Committee also recommends a revision to Virginia's prudent man rule to ensure investment flexibility, to the advantage of both Virginia beneficiaries and Virginia fiduciaries.

The Committee sees no interest contradiction in suggesting that both statutes, as amended, continue to be the law of Virginia. The statutes serve different needs: the legal list typically is of interest to the individual fiduciary while the prudent man rule is the investment measure of generally larger accounts frequently handled by professional fiduciaries. The

Committee believes the two changes, a narrowing of the legal list coupled with an updating of the prudent man rule, complement each other.

Respectfully submitted:

Michael Armstrong
James G. Arthur
Dennis I. Belcher
Thomas A. Davis
(Mrs.) Becky T. Kelly
R. Hart Lee
Joseph E. Machatton
Linda F. Rigsby
J. Hume Taylor, Jr.
Harry J. Warthen, III

Exhibit A

GENERAL ASSEMBLY OF VIRGINIA--1991 SESSION

HOUSE JOINT RESOLUTION NO. 395

Requesting the Virginia Bar Association and the Virginia Bankers' Association to study Virginia's codified list of fiduciary investments.

Agreed to by the House of Delegates, February 22, 1991
Agreed to by the Senate, February 21, 1991

WHEREAS, those lawful fiduciary investments listed in § 26-40 of the Virginia Code are intended to be extremely safe investments; and

WHEREAS, the list has not been substantially modified in many years; and

WHEREAS, there now exist investments that are extremely safe and valuable but are not set forth in the Code and there are investments set forth therein that are either not as safe or as valuable as when originally included; and

WHEREAS, the current limits imposed upon fiduciaries may hamper reasonable investment; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Wills, Trusts and Estates Section of the Virginia Bar Association and the Virginia Bankers' Association are requested to study the status of Virginia's lawful fiduciary investments, to recommend amendments, deletions and additions to the list and to make other recommendations as deemed appropriate.

The Associations are requested to complete their work in time to submit their findings and recommendations to the Governor and the 1992 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Exhibit B

commissioner until ten days after the list containing the name of such fiduciary as aforesaid shall have been so posted. (Code 1919, § 5423; 1924, p. 9; 1966, c. 324; 1991, c. 147.)

The 1991 amendment, in the first sentence, deleted "or corporation" following "the term of any circuit," substituted "city" for "corporation," substituted "during the first week of each month" for "on the first Monday in any month," and substituted "of such circuit court a list of the fiduciaries" for "of such circuit or corporation court a list of the fiduciaries."

§ 26-30. Expenses and commissions allowed fiduciaries.

Law Review.
For 1985 survey of Virginia wills, trusts, and estates law, see 19 U. Rich. L. Rev. 779 (1985).

§ 26-31. Accounts, etc., to be reported. — Every account stated under this chapter, including a statement of the cash on hand and in bank and the investments held by the fiduciary at the terminal date of the account, and, where applicable, reports of debts and demands under § 64.1-172 shall be reported, with any matters specially stated deemed pertinent by the commissioner, or which may be required by any person interested to be so stated. (Code 1919, § 5426; 1936, p. 250; 1989, c. 492.)

The 1989 amendment inserted "and, where applicable, reports of debts and demands under § 64.1-172."

Law Review. — For survey on wills, trusts, and estates in Virginia for 1989, see 23 U. Rich. L. Rev. 859 (1989).

§ 26-33. Exceptions; examination, correction and confirmation.

Additional evidence may be heard in circuit court to exceptions to commissioner's report. — Although this section does not explicitly provide for a further evidentiary hearing in circuit court when exceptions to a commissioner's report are heard, it is implicit in the statutory provision for jury trial that additional evidence may be adduced, and it is equally implicit that evidence which may be heard by a jury may also be heard ore tenus, in the court's discretion. Morris v. United Va. Bank, 237 Va. 331, 377 S.E.2d 611 (1989).

CHAPTER 3.

INVESTMENTS.

§ 26-40. In what securities fiduciaries may invest. — Executors, administrators, trustees, and other fiduciaries, both individual and corporate, may invest the funds held by them in a fiduciary capacity in the following securities, which are and shall be considered lawful investments:

(1) *Obligations of the Commonwealth.* — Stocks, bonds, notes, and other evidences of indebtedness of the Commonwealth of Virginia, and those

unconditionally guaranteed as to the payment of principal and interest by the Commonwealth of Virginia.

(2) *Obligations of the United States, etc.* — Stocks, bonds, treasury notes and other evidences of indebtedness of the United States, including the guaranteed portion of any loan guaranteed by the Small Business Administration, an agency of the United States government, and those unconditionally guaranteed as to the payment of principal and interest by the United States; and bonds of the District of Columbia, and bonds and notes of the Federal National Mortgage Association and the Federal Home Loan Banks, and bonds, debentures or other similar obligations of federal land banks, federal intermediate credit banks, or banks of cooperatives, issued pursuant to acts of Congress, and obligations issued by the United States Postal Service when the principal and interest thereon is guaranteed by the government of the United States. The evidences of indebtedness enumerated by this paragraph may be held directly or in the form of securities of any open-end or closed-end management type investment company or investment trust registered under the Investment Company Act of 1940, provided that the portfolio of such investment company or investment trust is limited to such evidences of indebtedness.

(3) *Obligations of other states.* — Stocks, bonds, notes and other evidences of indebtedness of any state of the United States upon which there is no default and upon which there has been no default for more than ninety days; provided, that within the twenty fiscal years next preceding the making of such investment, such state has not been in default for more than ninety days in the payment of any part of principal or interest of any debt authorized by the legislature of such state to be contracted.

(4) *Obligations of Virginia counties, cities, etc.* — Stocks, bonds, notes and other evidences of indebtedness of any county, city, town, district, authority or other public body in the Commonwealth of Virginia upon which there is no default; provided, that if the principal and interest be payable from revenues or tolls and the project has not been completed, or if completed, has not established an operating record of net earnings available for payment of principal and interest equal to estimated requirements for that purpose according to the terms of the issue, the standards of judgment and care required in § 26-45.1, without reference to this section, shall apply.

In any case in which an authority, having an established record of net earnings available for payment of principal and interest equal to estimated requirements for that purpose according to the terms of the issue, issues additional evidences of indebtedness for the purposes of acquiring or constructing additional facilities of the same general character that it is then operating, such additional evidences of indebtedness shall be governed fully by the provisions of this section without limitation.

(5) *Obligations of cities, counties, etc., of other states.* — Legally authorized stocks, bonds, notes and other evidences of indebtedness of any city, county, town or district situated in any one of the states of the United States upon which there is no default and upon which there has been no default for more than ninety days; provided, that (a) within the twenty fiscal years next preceding the making of such investment, such city, county, town or district has not been in default for more than ninety days in the payment of any part of principal or interest of any stock, bond, note or other evidence of indebtedness issued by it; (b) such city, county, town or district shall have been in continuous existence for at least twenty years; (c) such city, county, town or district has a population, as shown by the federal census next preceding the making of such investment, of not less than 25,000 inhabitants; (d) the stocks, bonds, notes or other evidences of indebtedness in which such investment is made are the direct legal obligations of the city, county, town or

district issuing the same; (e) the city, county, town or district has power to levy taxes on the taxable real property therein for the payment of such obligations without limitation of rate or amount; and (f) the net indebtedness of such city, county, town or district (including the issue in which such investment is made), after deducting the amount of its bonds issued for self-sustaining public utilities, does not exceed ten percent of the value of the taxable property in such city, county, town or district, to be ascertained by the valuation of such property therein for the assessment of taxes next preceding the making of such investment.

(5a) *Obligations subject to repurchase.* — Investments set forth in the first five paragraphs of this statute may also be made subject to the obligation or right of the seller to repurchase these on a specific date.

(6) *Bonds secured on real estate.* — Bonds and negotiable notes directly secured by a first lien on improved real estate or farm property in the Commonwealth of Virginia, or in any state contiguous to the Commonwealth of Virginia within a fifty-mile area from the borders of the Commonwealth of Virginia, not to exceed eighty percent of the fair market value of such real estate, including any improvements thereon at the time of making such investment, as ascertained by an appraisal thereof made by two reputable persons who are not interested in whether or not such investment is made.

(7) *Bonds secured on city property in Fifth Federal Reserve District.* — Bonds and negotiable notes directly secured by a first lien on improved real estate situated in any incorporated city in any of the states of the United States which lie wholly or in part within the Fifth Federal Reserve District of the United States as constituted on June 18, 1928, pursuant to the act of Congress of December 23, 1913, known as the Federal Reserve Act, as amended, not to exceed sixty percent of the fair market value of such real estate, with the improvements thereon, at the time of making such investment, as ascertained by an appraisal thereof made by two reputable persons who are not interested in whether or not such investment is made; provided, that such city has a population, as shown by the federal census next preceding the making of such investments, of not less than 5,000 inhabitants.

(8) *Bonds of Virginia educational institutions.* — Bonds of any of the educational institutions of the Commonwealth of Virginia, which have been or may be authorized to be issued by the General Assembly of the Commonwealth of Virginia.

(9) *Securities of the R. F. & P.* — Stocks, bonds and other securities of the Richmond, Fredericksburg and Potomac Railroad Company, including bonds or other securities guaranteed by the Richmond, Fredericksburg and Potomac Railroad Company.

(10) *Obligations of railroads.* — Bonds, notes and other evidences of indebtedness, including equipment trust obligations, which are direct legal obligations of or which have been unconditionally assumed or guaranteed as to the payment of principal and interest by, any railroad corporation operating within the United States which meets the following conditions and requirements:

(a) The gross operating revenue of such corporation for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have not been less than ten million dollars;

(b) The total fixed charges of such corporation, as reported for the fiscal year next preceding the making of the investment, shall have been earned an average of at least two times annually during the seven fiscal years preceding the making of the investment and at least 1½ times during the fiscal year immediately preceding the making of the investment (the term "total fixed

charges" as used in this paragraph shall be deemed to refer to the term used in the accounting reports of common carriers as prescribed by the regulations of the Interstate Commerce Commission); and

(c) The aggregate of the average market prices of the total amounts of each of the individual securities of such corporation junior to its bonded debt and outstanding at the time of the making of such investment shall be equal to at least two-thirds of the total fixed charges, as defined in paragraph (b) of clause (10) of this section, for such railroad corporation for the fiscal year next preceding the making of such investment capitalized at an interest rate of five percent per annum. Such average market price of any one of such individual securities shall be determined by the average of the highest quotation and the lowest quotation of the individual security for a period immediately preceding the making of such investment, which period shall be the full preceding calendar year plus the then expired portion of the calendar year in which such investment is made; provided, that if more than six months of the calendar year in which such investment is made shall have expired, then such period shall be only the then expired portion of the calendar year in which such investment is made; and provided further, that if such individual security shall not have been outstanding during the full extent of such period, such period shall be deemed to be the length of time such individual security shall have been outstanding.

(11) *Obligations of leased railroads.* — Stocks, bonds, notes, other evidences of indebtedness and any other securities of any railroad corporation operating within the United States the railroad lines of which have been leased by a railroad corporation, either alone or jointly with other railroad corporations, whose bonds, notes and other evidences of indebtedness shall, at the time of the making of such investment, qualify as lawful investments for fiduciaries under the terms of clause (10) of this section; provided, that the terms of such lease shall provide for the payment by such lessee railroad corporation individually, irrespective of the liability of other joint lessee railroad corporations, if any, in this respect, of an annual rental of an amount sufficient to defray the total operating expenses and maintenance charges of the lessor railroad corporation plus its total fixed charges, plus, in the event of the purchase of such a stock as aforesaid, a fixed dividend upon any issue of such stock in which such investment is made; and provided, that, if such investment so purchased shall consist of an obligation of definite maturity, such lease shall be one which shall, according to its terms, provide for the payment of the obligation at maturity or extend for a period of not less than twenty years beyond the maturity of such obligations so purchased, or if such investment so purchased shall be a stock or other form of investment having no definite date of maturity, such lease shall be one which shall, according to its terms, extend for a period of at least fifty years beyond the date of the making of such investment.

(12) *Equipment trust obligations.* — Equipment trust obligations issued under the "Philadelphia Plan" in connection with the purchase for use on railroads of new standard gauge rolling stock; provided that the owner, purchaser, or lessee of such equipment or one or more of such owners, purchasers, or lessees shall be a railroad corporation whose bonds, notes and other evidences of indebtedness shall, at the time of the making of such investment, qualify as lawful investments for fiduciaries under the terms of clause (10) of this section; and provided that all of such owners, purchasers, or lessees shall be both jointly and severally liable under the terms of such contract of purchase or lease, or both, for the fulfillment thereof.

(13) *Preferred stock of railroads.* — Any preference stock of any railroad corporation operating within the United States; provided such stock and such railroad corporation meet the following conditions and requirements:

(a) Such stock shall be preferred as to dividends, such dividends shall be cumulative and such stock shall be preferred as to assets in the event of liquidation or dissolution;

(b) The gross operating revenue of such corporation for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than ten million dollars;

(c) The total fixed charges, as defined in paragraph (b) of clause (10) of this section, of such corporation, as reported for the fiscal year next preceding the making of such investment, plus the amount, at the time of making such investment, of the annual dividend requirements on such preference stock and any preference stock having the same or senior rank, such fixed charges and dividend requirements being considered the same for every year, shall have been earned an average of at least 2½ times annually for the seven fiscal years preceding the making of such investment and at least two times for the fiscal year immediately preceding the making of such investment; and

(d) The aggregate of the average market prices of the total amount of each of the individual securities of such corporation, junior to such preference stock and outstanding at the time of the making of such investment, shall be at least equal to the par value of the total issue of the preference stock in question plus the total par value of all other issues of its preference stock having either the same rank as, or a senior rank to, the issue of such preference stock plus total fixed charges, as defined in paragraph (b) of clause (10) of this section, for such railroad corporation for the fiscal year next preceding the making of such investment capitalized at an interest rate of five percent annually. Such average market price of any one of such individual securities shall be determined in the same manner as prescribed in paragraph (c) of clause (10) of this section.

(14) *Obligations of public utilities.* — Bonds, notes and other evidences of indebtedness of any public utility operating company operating within the United States; provided such company meets the following conditions and requirements:

(a) The gross operating revenue of such public utility operating company for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than five million dollars;

(b) The total fixed charges of such corporation, as reported for the fiscal year next preceding the making of the investment, shall have been earned, after deducting operating expenses, depreciation and taxes, other than income taxes, an average of at least 1¾ times annually during the seven fiscal years preceding the making of the investment and at least 1½ times during the fiscal year immediately preceding the making of the investment;

(c) In the fiscal year next preceding the making of such investment the ratio of the total par value of the bonded debt of such public utility operating company including the total bonded indebtedness of all its subsidiary companies, whether assumed by the public utility operating company in question or not, to its gross operating revenue shall not be greater than four to one; and

(d) Such public utility operating company shall be subject to permanent regulation by a state commission or other duly authorized and recognized regulatory body.

The term "public utility operating company" as used in this clause (14) shall mean a public utility or public service corporation (i) of whose total income available for fixed charges for the fiscal year next preceding the making of

such investment at least fifty-five percent thereof shall have been derived from direct payments by customers for service rendered them, (ii) of whose total operating revenue for the fiscal year next preceding the making of such investment at least sixty percent thereof shall have been derived from the sale of electric power, gas, water, or telephone service and not more than ten percent thereof shall have been derived from traction operations, and (iii) whose gas properties are all within the limits of one state, if more than twenty percent of its total operating revenues are derived from gas.

(15) *Preferred stock of public utilities.* — Any preference stock of any public utility operating company operating within the United States; provided such stock and such company meet the following conditions and requirements:

(a) Such stock shall be preferred as to dividends, such dividends shall be cumulative, and such stock shall be preferred as to assets in the event of liquidation or dissolution;

(b) The gross operating revenue of such public utility operating company for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than five million dollars;

(c) The total fixed charges of such public utility operating company, as reported for the fiscal year next preceding the making of such investment, plus the amount, at the time of making such investment, of the annual dividend requirements on such preference stock and any preference stock having the same or senior rank, such fixed charges and dividend requirements being considered the same for every year, shall have been earned, after deducting operating expenses, depreciation and taxes, including income taxes, an average of at least two times annually for the seven fiscal years preceding the making of such investment and at least two times for the fiscal year immediately preceding the making of such investment;

(d) In the fiscal year next preceding the making of such investment, the ratio of the sum of the total par value of the bonded debt of such public utility operating company, the total par value of the issue of such preference stock, and the total par value of all other issues of its preference stock having the same or senior rank to its gross operating revenue shall not be greater than four to one; and

(e) Such public utility operating company shall be subject to permanent regulation by a state commission or other duly authorized and recognized regulatory body.

For the purposes of this clause (15) of this section, the term "public utility operating company" shall be construed in the same manner as defined in clause (14) of this section.

(16) *Obligations of the following telephone companies.* — Bonds, notes and other evidences of indebtedness of American Telephone and Telegraph, Bell Atlantic, Bell South, Southwestern Bell, Pacific Telesis, Nynex, American Information Technologies, or U.S. West; and bonds, notes and other evidences of indebtedness unconditionally assumed or guaranteed as to the payment of principal and interest by any such company; provided, that the total fixed charges, as reported for the fiscal year next preceding the making of the investment, of such company and all of its subsidiary corporations on a consolidated basis shall have been earned, after deducting operating expenses, depreciation and taxes, other than income taxes, an average of at least 1¾ times annually during the seven fiscal years preceding the making of the investment and at least 1½ times during the fiscal year immediately preceding the making of the investment.

(17) *Obligations of municipally owned utilities.* — The stocks, bonds, notes and other evidences of indebtedness of any electric, gas or water department

of any state, county, city, town or district whose obligations would qualify as legal for purchase under clause (3), (4) or (5) of this section, the interest and principal of which are payable solely out of the revenues from the operations of the facility for which the obligations were issued; provided, that the department issuing such obligations meet the requirements applying to public utility operating companies as set out in paragraphs (a), (b) and (c) of clause (14) of this section.

(18) *Obligations of industrial corporations.* — Bonds, notes and other evidences of indebtedness of any industrial corporation incorporated under the laws of the United States or of any state thereof; provided such corporation meets the following conditions and requirements:

(a) The gross operating revenue of such corporation for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than ten million dollars;

(b) The total fixed charges of such corporation, as reported for the fiscal year next preceding the making of the investment, shall have been earned, after deducting operating expenses, depreciation and taxes, other than income taxes, and depletion in the case of companies commonly considered as depleting their natural resources in the course of business, an average of at least three times annually during the seven fiscal years preceding the making of the investment and at least 2½ times during the fiscal year immediately preceding the making of the investment;

(c) The net working capital of such industrial corporation, as shown by its last published fiscal year-end statement prior to the making of such investment, or in the case of a new issue, as shown by the financial statement of such corporation giving effect to the issuance of any new security, shall be at least equal to the total par value of its bonded debt as shown by such statement; and

(d) The aggregate of the average market prices of the total amounts of each of the individual securities of such industrial corporation, junior to its bonded debt and outstanding at the time of the making of such investment, shall be at least equal to the total par value of the bonded debt of such industrial corporation at the time of the making of such investment, such average market price of any one of such individual securities being determined in the same manner as prescribed in paragraph (c) of clause (10) of this section.

(19) *Preferred stock of industrial corporations.* — Any preference stock of any industrial corporation incorporated under the laws of the United States or of any state thereof; provided such stock and such industrial corporation meet the following conditions and requirements:

(a) Such stock shall be preferred as to dividends, such dividends shall be cumulative and such stock shall be preferred as to assets in the event of liquidation or dissolution;

(b) The gross operating revenue of such corporation for the fiscal year preceding the making of such investment, or the average of the gross operating revenue for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than ten million dollars;

(c) The total fixed charges of such corporation, as reported for the fiscal year next preceding the making of such investment, plus the amount, at the time of making such investment, of the annual dividend requirements on such preference stock and any preference stock having the same or senior rank such fixed charges and dividend requirements being considered the same for every year, shall have been earned, after deducting operating expenses depreciation and taxes, including income taxes, and depletion in the case o

companies commonly considered as depleting their natural resources in the course of business, an average of at least four times annually for the seven fiscal years preceding the making of such investment and at least three times for the fiscal year immediately preceding the making of such investment;

(d) The net working capital of such industrial corporation, as shown by its last published fiscal year-end statement prior to the making of such investment, or, in the case of a new issue, as shown by the financial statement of such corporation giving effect to the issuance of any new security, shall be at least equal to the total par value of its bonded debt plus the total par value of the issue of such preference stock plus the total par value of all other issues of its preference stock having the same or senior rank; and

(e) The aggregate of the lowest market prices of the total amounts of each of the individual securities of such industrial corporation junior to such preference stock and outstanding at the time of the making of such investment shall be at least 2½ times the par value of the total issue of such preference stock plus the total par value of all other issues of its preference stock having the same or senior rank plus the par value of the total bonded debt of such industrial corporation. Such lowest market price of any one of such individual securities shall be determined by the lowest single quotation of the individual security for a period immediately preceding the making of such investment, which period shall be the full preceding calendar year plus the then expired portion of the calendar year in which such investment is made; and provided, that if such individual security shall not have been outstanding during the full extent of such period, such period shall be deemed to be the length of time such individual security shall have been outstanding.

(20) *Obligations of finance corporations.* — Bonds, notes and other evidences of indebtedness of any finance corporation incorporated under the laws of the United States or of any state thereof; provided such corporation meets the following conditions and requirements:

(a) The gross operating income of such corporation for the fiscal year preceding the making of such investment or the average of the gross operating income for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than five million dollars;

(b) The total fixed charges of such corporation, as reported for the fiscal year next preceding the making of the investment, shall have been earned, after deducting operating expenses, depreciation and taxes, other than income taxes, an average of at least 2½ times annually during the seven fiscal years preceding the making of the investment and at least two times during the fiscal year immediately preceding the making of the investment;

(c) The aggregate indebtedness of such finance corporation as shown by its last fiscal year-end statement, or, in the case of a new issue, as shown by the financial statement giving effect to the issuance of any new securities, shall be no greater than three times the aggregate net worth, as represented by preferred and common stocks and surplus of such corporation; and

(d) The aggregate of the average market prices of the total amounts of each of the individual securities of such finance corporation, junior to its bonded debt and outstanding at the time of the making of such investment, shall be at least equal to one-third of the sum of the par value of the bonded debt plus all other indebtedness of such finance corporation as shown by the last published fiscal year-end statement, such average market price of any one of such individual securities being determined in the same manner as prescribed in paragraph (c) of clause (10) of this section.

(21) *Preferred stock of finance corporations.* — Any preference stock of any finance corporation, incorporated under the laws of the United States or of

any state thereof; provided, such stock and such corporation meet the following conditions and requirements:

(a) Such stock shall be preferred as to dividends, such dividends shall be cumulative, and such stock shall be preferred as to assets in the event of liquidation or dissolution;

(b) The gross operating income of such corporation for the fiscal year preceding the making of such investment or the average of the gross operating income for the five fiscal years next preceding the making of such investment, whichever of these two is the larger, shall have been not less than five million dollars;

(c) The total fixed charges of such finance corporation, as reported for the fiscal year next preceding the making of such investment, plus the amount, at the time of making such investment, of the annual dividend requirements on such preference stock and any preference stock having the same or senior rank, such fixed charges and dividend requirements being considered the same for every year, shall have been earned, after deducting operating expenses, depreciation and taxes, including income taxes, an average of at least 3½ times annually for the seven fiscal years preceding the making of such investment and at least three times for the fiscal year immediately preceding the making of such investment;

(d) The aggregate indebtedness and par value of the purchased stock, both the issue in question and any issues equal or senior thereto, of such finance corporation as shown by its last published fiscal year-end statement, or in the case of a new issue as shown by the financial statement giving effect to the issuance of any new securities, shall be no greater than three times the aggregate par value of the junior securities and surplus of such corporation; and

(e) The aggregate of the lowest market prices of the total amounts of each of the individual securities of such finance corporation junior to such preference stock and outstanding at the time of the making of such investment shall be at least equal to one-third of the sum of the par value of such preference stock plus the total par value of all other issues of preference stock having the same or senior rank plus the par value of the total bonded debt plus all other indebtedness of such finance corporation as shown by the last published fiscal year-end statement, such lowest market price of any one of such individual securities being determined in the same manner as prescribed in paragraph (e) of clause (19) of this section.

(22) *Federal housing loans.* — First mortgage real estate loans insured by the Federal Housing Administrator, under Title II of the National Housing Act.

(23) *Certificates of deposit and savings accounts.* — Certificates of deposit of, and savings accounts in, any bank, banking institution or trust company, whose deposits are insured by the Federal Deposit Insurance Corporation at the prevailing rate of interest on such certificates or savings accounts; provided, however, no such fiduciary shall invest in such certificates of, or deposits in, any one bank, banking institution or trust company an amount from any one fund in his or its care which shall be in excess of such amount as shall be fully insured as a deposit in such bank, banking institution or trust company by the Federal Deposit Insurance Corporation. A corporate fiduciary shall not, however, be prohibited by the terms of this clause (23) of this section from depositing in its own banking department, in the form of demand deposits, savings accounts, time deposits or certificates of deposit, funds in any amount awaiting investments or distribution, provided that it shall have complied with the provisions of §§ 6.1-23 and 6.1-21, with reference to the securing of such deposits.

(24) *Obligations of International Bank, Asian Development Bank and African Development Bank.* — Bonds and other obligations issued, guaranteed or assumed by the International Bank for Reconstruction and Development, by the Asian Development Bank or by the African Development Bank.

(25) *Deposits in savings institutions.* — Certificates of deposit of, and savings accounts in, any state or federal savings institution or savings bank lawfully authorized to do business in this Commonwealth whose accounts are insured by the Federal Deposit Insurance Corporation or other federal insurance agency; however, no such fiduciary shall invest in such shares of any one such association an amount from any one fund in his or its care which shall be in excess of such amount as shall be fully insured as an account in such association by the Federal Deposit Insurance Corporation or other federal insurance agency.

(26) *Certificates evidencing ownership of undivided interests in pools of mortgages.* — Certificates evidencing ownership of undivided interests in pools of bonds or negotiable notes directly secured by first lien deeds of trust or mortgages on real property located in the Commonwealth of Virginia improved by single-family residential housing units or multi-family dwelling units; provided that (i) such certificates are rated AA or better by a nationally recognized independent rating agency; (ii) the loans evidenced by such bonds or negotiable notes do not exceed eighty percent of the fair market value, as determined by an independent appraisal thereof, of the real property and the improvements thereon securing such loans; and (iii) such bonds or negotiable notes are assigned to a corporate trustee for the benefit of the holders of such certificates.

(27) Shares and share certificates in any credit union lawfully authorized to do business in this Commonwealth whose accounts are insured by the National Credit Union Share Insurance Fund or the Virginia Credit Union Share Insurance Corporation; provided no such fiduciary shall invest in such shares an amount from any one fund in his or its care which shall be in excess of such amount as shall be fully insured as an account in such credit union by the National Credit Union Share Insurance Fund or the Virginia Credit Union Share Insurance Corporation. (Code 1919, § 5431; 1918, pp. 271, 454; 1920, p. 556; 1928, p. 1109; 1933, p. 79; 1934, p. 831; 1936, p. 172; 1942, p. 652; 1952, c. 196; 1954, c. 600; 1956, c. 83; 1958, c. 281; 1960, c. 589; 1970, c. 73; 1971, Ex. Sess., cc. 115, 245; 1973, c. 353; 1974, c. 557; 1982, c. 496; 1984, c. 264; 1985, cc. 362, 399; 1990, c. 3; 1991, c. 697.)

The 1990 amendment, in subdivision (25), substituted "savings institutions" for "savings and loan associations" in the heading, substituted "Certificates of deposit" for "Certificates of deposits" at the beginning of the subdivision, substituted "savings institution" for "savings and loan association" near the beginning of the subdivision, substituted "Federal Deposit Insurance Corporation or other federal insurance agency" for "Federal Savings and Loan Insurance Corporation" in two places, and deleted "provided" preceding "however" near the middle of the subdivision.

The 1991 amendment, in subdivision (16), substituted "following telephone companies" for "A. T. & T. Co.," deleted "the" following "evidences of indebtedness of" deleted "Company" following "American Telephone and Telegraph," inserted "Bell Atlantic, Bell South, Southwestern Bell, Pacific Telesis, Nynex, American Information Technologies, or U.S. West," and substituted "any such company" for "the American Telephone and Telegraph Company."

Law Review. — For article, "The Fiduciary Rights of Shareholders," see 29 Wm. & Mary L. Rev. 823 (1988).

§ 26-40.2. Investments in municipal bonds by banks or trust companies. — Subject to § 26-45.1 and the common law duties of a fiduciary, unless the governing instrument or a court order specifically directs otherwise, a bank or trust company serving as personal representative, trustee, guardian,

the statement for the fiscal year preceding such purchase, provided the date of such purchase is not more than four months after the end of the last fiscal year of the corporation. (Code 1919, § 5431; 1942, p. 661.)

§ 26-43. When pro forma fixed charges or dividend requirements may be used. — In testing a new issue of securities under the provisions of § 26-40, it shall be permissible, in determining the number of times that fixed charges or preferred dividend requirements have been earned, to use pro forma fixed charges or dividend requirements, provided the corporation or its corporate predecessor has been in existence for a period of not less than seven years. (Code 1919, § 5431; 1942, p. 662.)

§ 26-44. Investments that cease to be eligible may be retained. — Investments made under the provisions of § 26-40, if in conformity with the requirements of such section at the time such investments were made, may be retained even though they cease to be eligible for purchase under the provisions of such section, unless the exercise of reasonable care requires the sale or other disposition of such investments. (Code 1919, § 5431; 1942, p. 662.)

§ 26-45: Repealed by Acts 1977, c. 152.

§ 26-45.1. Standard of judgment and care required; authorized investments. — (a) Except with respect to the securities described in § 26-40, in acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another, an executor, administrator, trustee or other fiduciary, both individual and corporate, shall exercise the judgment of care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital. Within the limitations of the foregoing standard, an executor, administrator, trustee or other fiduciary, both individual and corporate, is authorized to acquire and retain every kind of property, real, personal or mixed, and every kind of investment, specifically including but not by way of limitation, debentures and other corporate obligations and stocks, preferred or common, and securities of any open-end or closed-end management type investment company or investment trust registered under the Federal Investment Company Act of 1940, as from time to time amended, which men of prudence, discretion and intelligence acquire or retain for their own account; and within the limitations of the foregoing standard, an executor, administrator, trustee or other fiduciary, both individual and corporate, may retain property properly acquired, without limitation as to time and without regard to its suitability for original purchase. Also, within the limitations of the foregoing standard, a corporate executor, administrator, trustee or other corporate fiduciary is authorized to retain as received its own stock or securities or the stock or securities of a corporation owning eighty percent or more of its common stock, or any stock or securities received in exchange for any such investments.

(b) Nothing contained in this section shall be construed as authorizing any departure from, or variation of, the express terms or limitations set forth in any will, agreement, court order or other instrument creating or defining an executor's, administrator's, trustee's or other fiduciary's duties and powers, but the terms "legal investment" or "authorized investment" or words of similar import, as used in any such instrument, shall be taken to mean any investment which is permitted by the terms of paragraph (a) hereof.

(c) Nothing contained in this section shall be construed as restricting the power of a court of proper jurisdiction to permit an executor, administrator,

trustee or other fiduciary, both individual and corporate, to deviate from the terms of any will, agreement, or other instrument relating to the acquisition, investment, reinvestment, exchange, retention, sale or management of fiduciary property.

(d) The provisions of this section shall govern executors, administrators, trustees or other fiduciaries, both individual and corporate, acting under wills, agreements, court orders and other instruments now existing or hereafter made.

(e) A general authorization in a will or trust authorizing a fiduciary to invest in such assets as the fiduciary, in his sole discretion, may deem best, or other language purporting to expand the fiduciary's investment powers, shall not be construed to waive the rule of paragraph (a) hereof unless the testator or settlor shall expressly manifest an intention that it be waived (i) by reference to the "prudent man" rule, (ii) by reference to the power of the fiduciary to make "speculative" investments, or (iii) by other language synonymous with (i) or (ii) immediately preceding. (1956, c. 660; 1972, c. 740; 1982, c. 549.)

Editor's note. — Acts 1982, c. 549, which substituted "§ 26-40" for "§§ 6.1-184 and 26-40" in the first sentence of subsection (a) and added subsection (e), provides, in s. 2: "That the provisions of this act are declaratory of existing law."

Law Review. — For note on conflict of interest and the duty of loyalty in fiduciary administration, see 47 Va. L. Rev. 1105 (1961). For survey of Virginia law on business associations for the year 1972-73, see 59 Va. L. Rev. 1412 (1973).

This section may be applied to trusts created before its passage. Goodridge v. National Bank of Commerce, 200 Va. 511, 106 S.E.2d 598 (1959).

Where there is nothing in the trust instruments to indicate that the trustor intended to restrict investments to those enumerated in the statutes in effect at the time of the execution of the instruments, it is the natural and legal presumption that the trustor intended that the trustees could make such investments as were lawful and proper under the statutes in effect at the time the investments were made. To give effect to such intention impairs no contract and takes away no vested property right. Goodridge v. National Bank of Commerce, 200 Va. 511, 106 S.E.2d 598 (1959).

Effect of waiver. — In order to impose liability against a trustee in regard to its investments of assets of a marital trust created by a will in which the testator granted the widest discretionary powers to the trustee and waived the "prudent man" rule, it would have to be alleged and proved that the trustee acted dishonestly or in bad faith, or abused the discretion vested in it. Hoffman v. First Va. Bank, 220 Va. 834, 263 S.E.2d 402 (1980), decided under this section as it stood before the 1982 amendment, which added subsection (e).

Constructive fraud through misuse of funds. — Administratrix, acting in her fiduciary capacity, whether as the personal representative of the deceased or under an agreement between the beneficiaries of the will, did not meet the "prudent man" standard required of her by this section where her handling of the estate amounted to constructive fraud through a flagrant misuse of the funds entrusted to her, especially the authorization of a $33^1/_3\%$ contingency fee to her attorneys which she concealed from the other beneficiaries. Kitchen v. Throckmorton, 223 Va. 164, 286 S.E.2d 673 (1982).

Applied in Carter v. Cavalier Cent. Bank & Trust Co., 223 Va. 571, 292 S.E.2d 305 (1982).

§ 26-45.2. Placing certain trust assets in designated financial institutions; waiver or reduction of bond of fiduciary officer. — (1) Notwithstanding any provisions of law to the contrary, whenever it shall be deemed expedient in the judgment of any court having jurisdiction of any estate in process of administration by any guardian, curator, executor, administrator, trustee, receiver, or other officer, because the size of the bond required of such officer shall seem burdensome or for other cause, the court may order such portion or all of the personal assets of the estate, as it shall deem proper, to be placed with such bank, trust company or savings and loan association, which savings and loan association is a member of the federal savings and loan insurance corporation, and doing business in this State, as the court shall

§ 26-40.01 In what securities fiduciaries may invest; Definitions. - A. As used in this section:

"Fiduciary" shall be defined as in § 8.01-2 and shall also include any attorney-in-fact or agent acting for a principal under a written power of attorney;

"National rating service" shall mean Standard & Poor's Corporation, Moody's Investors Service, Inc., Fitch Investors Corporation and any successor to the rating business of any of them.

B. Notwithstanding any other provision of law designating as legal investments for fiduciaries the bonds, notes, obligations or other evidences of indebtedness issued by a governmental entity or political subdivision of the Commonwealth, including but not limited to agencies, authorities, commissions, districts, boards, or local governments, but except as specifically provided in § 26-40, fiduciaries, whether individual or corporate, shall be conclusively presumed to have been prudent in investing the funds held by them in a fiduciary capacity in only the following securities:

1. Obligations of the Commonwealth, Its Agencies and Political Subdivisions. - The following obligations:

(a) bonds, notes and other evidences of indebtedness of the Commonwealth, and securities unconditionally guaranteed as to the payment of principal and interest by the Commonwealth;

(b) revenue bonds, notes or other evidences of revenue indebtedness issued by agencies or authorities of the Commonwealth upon which there is no default; and

(c) bonds, notes and other evidences of indebtedness of any county, city, town, district, authority or other public body in the Commonwealth upon which there is no default provided that such bonds, notes and other evidences of indebtedness are (i) direct legal obligations of the public body for payment of which the public body has pledged its full faith and credit and unlimited taxing power, or (ii) unconditionally guaranteed as to the payment of principal and interest by the public body.
In every case in this subsection B, such bonds, notes or other evidences of indebtedness shall be rated in one of the two highest rating categories of at least one national rating service and not rated in a category lower than the two highest rating categories of any national rating service. Determination of an obligation's rating in one of the two highest rating categories as required below shall be made without regard to any refinement or gradation of such rating category by numerical or other modifier. In addition, the remaining maturity of such bonds, notes or other evidences of indebtedness shall not be greater than five years.

2. Obligations of the United States. - Bonds, notes and other obligations of the United States, and securities unconditionally guaranteed as to the payment of principal and

interest by the United States with a remaining maturity not greater than five years except in the case of savings bonds, which may have a longer maturity. The obligations enumerated in this subdivision may be held directly, or in the form of securities of any open-end or closed-end management type investment company or investment trust registered under the Investment Company Act of 1940, provided that the portfolio of such investment company or investment trust is limited to such obligations.

3. Savings accounts, time deposits or certificates of deposit. - Savings accounts, time deposits or certificates of deposit in any bank, savings bank, trust company, savings and loan association or credit union authorized to do business as such in this Commonwealth, but only to the extent that such accounts, deposits or certificates are fully insured by the Federal Deposit Insurance Corporation or any successor federal agency or by the National Credit Union Share Insurance Fund or any successor to it.

C. Notwithstanding the provisions of this section, investments listed in § 26-40 as in effect prior to July 1, 1992 which continue to be held on July 1, 1992, shall be subject to § 26-45.1, and any reference to the Virginia "legal list" or to § 26-40 or any predecessor statute contained in a will, trust or other instrument that was irrevocable on June 30, 1992, shall be construed to refer to such section as in effect on June 30, 1992

or at such earlier time as may be specified in the controlling document, absent an expression of intent to the contrary contained in such document.

D. The permissible investments specified in subsection B are not exclusive and shall not be construed to limit investments permitted pursuant to § 26-45.1.

§ 26-44. Investments that cease to be eligible may be retained. -- Investments made under the provisions of § 26-40.01, if in conformity with the requirements of such section at the time such investments were made, may be retained even though they cease to be eligible for purchase under the provisions of § 26-40.01 **but shall be subject to the provisions of § 26-45.1.** ~~unless the exercise of reasonable care requires the sale or other disposition of such investments.~~

§ 26-45.1. Standard of judgment and care required; authorized investments. -- ~~(a)~~ A. Except with respect to the securities described in ~~§ 26-40~~ § 26-40.01 and for those investments authorized by § 26-40, in acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another, ~~an executor, administrator, trustee or other~~ a fiduciary, ~~both~~ whether individual ~~and~~ or corporate, shall exercise the judgment of care, skill, prudence and diligence under the circumstances prevailing from time to time ~~then prevailing ; which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of their capital.~~ (including, but not limited to, general economic conditions, anticipated tax consequences, the duties of the fiduciary and the interests of all beneficiaries) that a prudent person familiar with such matters and acting in his own behalf would exercise under the circumstances in order to accomplish the purposes set forth in the controlling document. In investing pursuant to this standard, a fiduciary shall consider individual investments in the context of the investment portfolio as a whole and as part of the fiduciary's overall investment plan and shall have a duty to diversify investments unless, under the circumstances, it is prudent not to do so. Any determination of liability for investment performance shall consider not only the performance of a particular investment, but also the performance of the

portfolio as a whole. ~~Also~~ Within the limitations of the foregoing standard, ~~an executor, administrator, trustee or other~~ a fiduciary~~, both individual and corporate,~~ is authorized to acquire and retain every kind of property, real, personal or mixed, and every kind of investment, ~~specifically including but not by way of limitation, debentures and other corporate obligations and stocks, preferred or common, and securities of any open-end or closed-end management type investment company or investment trust registered under the Federal Investment Company Act of 1940, as from time to time amended,~~ which ~~men~~ persons of prudence, discretion and intelligence might acquire or retain for their own account~~; and within the limitations of the foregoing standard, an executor, administrator, trustee or other fiduciary, both individual and corporate, may retain property properly acquired, without limitation as to time and without regard to its suitability for original purchase~~ under the circumstances. Also, within the limitations of the foregoing standard, a corporate ~~executor, administrator, trustee or other~~ fiduciary is authorized to retain as received its own stock or securities or the stock or securities of a corporation owning eighty percent or more of its common stock, or any stock or securities received in exchange for any such investments.

~~(b)~~ B. Nothing contained in this section shall be construed as authorizing any departure from, or variation of, the express terms or limitations set forth in ~~any will, agreement~~ the

controlling document~~, court order or other instrument~~ creating or defining ~~an executor's, administrator's, trustee's or other~~ a fiduciary's duties and powers, but the terms "legal investment", ~~or~~ "authorized investment", "prudent man (or prudent investor) investment" or words of similar import, as used in any such instrument, shall be taken to mean any investment ~~which~~ that is permitted by the terms of ~~paragraph (a) hereof~~ subsection A.

~~(c)~~ C. Nothing contained in this section shall be construed as restricting the power of a court of proper jurisdiction to permit ~~an executor, administrator, trustee or other~~ a fiduciary, ~~both individual and corporate,~~ to deviate from the terms of any ~~will, agreement, or other instrument~~ controlling document relating to the acquisition, investment, reinvestment, exchange, retention, sale or management of fiduciary property.

~~(d)~~ D. The provisions of this section shall govern ~~executors, administrators, trustees or other~~ fiduciaries~~, both individual and corporate,~~ acting under controlling documents ~~wills, agreements, court orders and other instruments~~ now existing or hereafter made.

~~(e)~~ E. A controlling document may waive the rule of subsection (A). A general authorization in a ~~will or trust~~ controlling document authorizing a fiduciary to invest in such assets as the fiduciary, in his sole discretion, may deem best, or other language purporting to expand the fiduciary's investment powers, shall not be construed to waive the rule of ~~the paragraph~~

~~(a)~~ subsection A unless the controlling document ~~testator or settlor~~ shall expressly manifest an intention that it be waived (i) by reference to the "prudent man" or "prudent investor" rule, (ii) by reference to the power of the fiduciary to make "speculative" investments, ~~or~~ (iii) by an express authorization to acquire or retain a specific asset or type of asset such as any closely held business, or (iv) by other language synonymous with (i), ~~or~~ (ii) or (iii) ~~immediately preceding~~. A fiduciary shall not be liable to a beneficiary for the fiduciary's good faith reliance on a waiver of the rule of paragraph (a).

(f) As used in this section, "fiduciary" shall be defined as in § 8.01-2 and shall include any attorney-in-fact or agent acting for a principal under a written power of attorney. "Controlling document" means the will, agreement, power of attorney, court order or other instrument creating the fiduciary's powers.