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EXPLANATION OF S.B. 196
(Prepared by the Legal Division)

This bill enacts the Uniform Prudent Investor Act and the Uniform Principal and Income Act (1997).

Section 1 of this bill amends chapter 164 of NRS by adding thereto the provisions set forth as sections 2 to 44, inclusive, of this bill.

Section 2 of this bill sets forth the definitions for sections 2 to 44, inclusive, of this bill.

Section 3 of this bill provides that in performing his duties, a fiduciary shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in sections 2 to 44, inclusive, of this bill. If the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration, the fiduciary shall administer a trust or estate in accordance with sections 2 to 44, inclusive, of this bill.

Section 4 of this bill provides that a trustee shall invest and manage the trust property solely in the interest of the beneficiaries.

Section 5 of this bill provides that if a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust property, taking into account any differing interests of the beneficiaries.

Section 6 of this bill provides that sections 2 to 14, inclusive, of this bill may be cited as the Uniform Prudent Investor Act.

Section 7 of this bill provides that a trustee who invests and manages trust property owes a duty to the beneficiaries of the trust to comply with the prudent investor rule as set forth in sections 2 to 14, inclusive, of this bill but a trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the terms of the trust.

Section 8 of this bill provides that a trustee shall invest and manage trust property as a prudent investor would, considering the terms, purposes, requirements for distribution, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

Section 9 of this bill provides that a trustee shall diversify the investments of the trust unless he reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Section 10 of this bill provides that within a reasonable time after accepting a trusteeship or receiving trust property, a trustee shall review the trust property and make and carry out decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, requirements for distribution and other circumstances of the trust, and with the requirements of sections 2 to 14, inclusive, of this act.

Section 11 of this bill provides that in investing and managing trust property, a trustee may only incur costs that are appropriate and reasonable in relation to the property, the purposes of the trust and the skills of the trustee.

Section 12 of this bill provides that compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight.

Section 13 of this bill provides that a trustee may delegate functions of investment and management that a prudent trustee of comparable skills could properly delegate under the circumstances.

Section 14 of this bill sets forth the terms or comparable language in the terms of a trust which authorize any investment or strategy permitted under sections 2 to 14, inclusive, of this bill.

Section 15 of this bill provides that section 2, subsection 2 of section 5 and sections 15 to 44, inclusive, of this bill may be cited as the Uniform Principal and Income Act (1997).

Section 16 of this bill sets forth the definitions for sections 15 to 44, inclusive, of this bill.

Section 17 of this bill provides that in allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 19 to 23, inclusive, of this bill, a fiduciary shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and sections 15 to 44, inclusive, of this act do not provide a rule for allocating the receipt or disbursement to or between principal and income.

Section 18 of this bill provides that a trustee may adjust between principal and income to the extent he considers necessary if he invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and he determines, after applying the rules in sections 3 and 17 of this bill, that he is unable to comply with subsection 5 of this bill.

Section 19 of this bill sets forth the rules that apply after a decedent dies, in the case of an estate, or after an income interest in a trust ends.

Section 20 of this bill provides that each beneficiary described in section 19 of this bill is entitled to receive a portion of the net income equal to his fractional interest in undistributed principal assets, using values as of the date of distribution. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each date of distribution, to the net income the fiduciary has received after the date of death or terminating event or earlier date of distribution but has not distributed as of the current date of distribution.

Section 21 of this bill provides that an income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest. This section sets forth the date on which an asset becomes subject to a trust and the date on which an asset becomes subject to a successive income interest.

Section 22 of this bill provides when a trustee shall allocate an income receipt or disbursement.

Section 23 of this bill provides that when a mandatory income interest ends, the trustee shall pay to a mandatory income beneficiary who survives that date, or the estate of a deceased mandatory income beneficiary whose death causes the interest to end, his share of the undistributed income[1] that is not disposed of under the terms of the trust unless he has an unqualified power to revoke more than 5 percent of the trust immediately before the income interest ends. In the latter case, the undistributed income from the portion of the trust that may be revoked must be added to principal. When a trustee's obligation to pay a fixed annuity or a fixed fraction of the value of the trust's assets ends, he shall prorate the final payment if and to the extent required by applicable law to accomplish a purpose of the trust or its settlor relating to income, gift, estate or other tax requirement.

Section 24 of this bill provides that a trustee shall allocate to income money received from an entity[2] except for certain receipts which must be allocated to principal.

Section 25 of this bill provides that a trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 24 or 38 of this bill applies to a receipt from the trust.

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[1] "Undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

[2] "Entity" means a corporation, partnership, limited-liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a trustee has an interest other than a trust or estate to which section 25 of this bill applies, a business or activity to which section 26 of this bill applies or an asset-backed security to which section 38 of this bill applies.

Section 26 of this bill provides that if a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, he may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

Section 27 of this bill sets forth the items that a trustee shall allocate to principal.

Section 28 of this bill provides that to the extent that a trustee accounts for receipts from rental property pursuant to this section, he shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, must be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

Section 29 of this bill provides that an amount received as interest, whether determined at a fixed, variable, or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, must be allocated to income without any provision for amortization of premium. A trustee shall allocate to principal an amount received from the sale, redemption, or other disposition of an obligation to pay money to him more than one year after it is purchased or acquired by him, including an obligation whose purchase price or value when it is acquired is less than its value at maturity. If the obligation matures within one year after it is purchased or acquired by the trustee, an amount received in excess of its purchase price or its value when acquired by the trust must be allocated to income.

Section 30 of this bill provides that a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of, or loss of title to a trust asset. He shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal. A trustee shall allocate to income proceeds of a contract that insures him against loss of occupancy or other use by an income beneficiary, loss of income, or, subject to section 26 of this act, loss of profits from a business.

Section 31 of this bill provides that if a trustee determines that an allocation between principal and income is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection 3 of section 18 of this act applies to the allocation.

Section 32 of this bill provides that to the extent that a payment[3] is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. He shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.

Section 33 of this bill provides that a trustee shall allocate to income 10 percent of the receipts from a liquidating asset[4] and the balance to principal.

Section 34 of this bill sets forth the manner in which a trustee, to the extent that he accounts for receipts from an interest in minerals or other natural resources, must allocate them.

Section 35 of this bill sets forth the manner in which a trustee, to the extent that he accounts for receipts from the sale of timber and related products, must allocate the net receipts.

Section 36 of this bill provides that if a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the surviving spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 18 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time, or exercise the power conferred by subsection 1 of section 18 of this act. The trustee may decide which action or combination of actions to take.

Section 37 of this bill provides that to the extent that a trustee accounts for transactions in derivatives[5] pursuant to this section, he shall allocate to principal receipts from and disbursements made in connection with those transactions.

Section 38 of this bill provides that if a trust receives a payment from interest or other current return and from other proceeds of the collateral financial assets, the trustee shall allocate to income the portion of the payment which the payor identifies as being from interest or other current return and shall allocate the balance of the payment to principal. If a trust receives one or more payments in exchange for the trust's entire

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[3] "Payment" means a payment that a trustee may receive over a fixed number of years or during the life of one or more natural persons because of services rendered or property transferred to the payor in exchange for future payments.
[4] "Liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration.
[5] "Derivative" means a contract of financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates, or other market indicator for an asset or a group of assets.

interest in an asset-backed security[6] in one accounting period, the trustee shall allocate the payments to principal. If a payment is one of a series of payments that will result in the liquidation of the trust's interest in the security over more than one accounting period, the trustee shall allocate 10 percent of the payment to income and the balance to principal.

Section 39 of this bill sets forth the disbursements from income that a trustee shall make.

Section 40 of this bill sets forth the disbursements from principal that a trustee shall make.

Section 41 of this bill provides that a fiduciary may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation and sets forth the circumstances under which a fiduciary may not transfer any amount for depreciation.[7]

Section 42 of this bill provides that if a trustee makes or expects to make a principal disbursement, he may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

Section 43 of this bill sets forth the manner by which a trustee is to pay a tax based on receipts allocated to income, based on receipts allocated to principal and on the trust's share of an entity's taxable income.

Section 44 of this bill provides that a fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from certain circumstances.

Sections 45 to 48, inclusive, of this bill amend or repeal related sections pertaining to the enactment of the Uniform Prudent Investor Act and the Uniform Principal and Income Act (1997).

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[6] "Asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 24 or 32 of this act applies.

[7] "Depreciation" means a reduction in value due to wear, tear, decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more than one year.