

Trustee Boot Camp

Getting Started as a Trustee with Administrative Checklists

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May 11, 2018

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Dave Folz

Dave got his law degree at the Georgetown University Law Center in Washington, D.C., and then spent seven years in Chicago at Continental Illinois National Bank learning about the trust world. While he was there, he attended the John Marshall Law School and got a Masters in Tax, doing his thesis on IRA Rollovers. In 1980, the First National Bank in Dallas recruited him to Texas, and “he got here as soon as he could.”

Since then he has started two Wealth Management and Trust Groups, the first in 1987 at NorthPark National Bank (now Comerica) and the second in 1999 at Texas Capital Bank. He retired from Texas Capital in 2015 and since has consulted for and coached individual trustees. He also serves as an expert witness on investment and trust matters.

Dave has been active with the Wealth Management and Trust Division of the Texas Bankers Association, serving on its Administrative Council and its Governmental Relations Committee, twice as Chair, and has been active in its legislative efforts.

Dave is involved with the community, serving for many years with the Dallas Metropolitan YMCA in a variety of Board capacities. He also serves on the Parkland Hospital Investment Advisory Committee as Chair and the Investment Committee of the Theodore Roosevelt Association. He is the current Secretary for the Preston Center Rotary.

TRUSTEE = FIDUCIARY

BLACK'S LAW DICTIONARY "Fiduciary"

Someone who is required to act for the benefit of another person on all matters within the scope of their relationship;

One who owes to another the duties of good faith, loyalty, due care, and disclosure;

Someone who must exercise a high standard of care in managing another's money or property.

TRUSTEE DUTIES

Duty to collect, preserve, and maintain trust property

Duty to administer the trust according to its terms

Duty to make trust assets productive

Duty to diversify

Duty to provide an accounting

Duty to disclose material facts

Duty of skill and care

Duty to segregate trust assets

Duty of impartiality

Duty of loyalty

Duty to avoid conflicts of interests

Duty to enforce and defend claims

Duty to give notice

Duty of confidentiality with respect to the trust and the beneficiaries

DOCUMENT

DOCUMENT

DOCUMENT

GETTING ORGANIZED – ADMINISTRATIVE STEPS

Original Trust, Amendments, Court Decrees, Family Settlement Agreements

Are there any prior trustee resignations and successor appointments?

Who is the attorney and the CPA for the Trust?

Has the attorney/CPA applied for the Tax Identification Number for the Trust?

Federal estate tax returns, if filed

Mailing address, email address, birthdates, health status and social security numbers of the beneficiaries

Do any of the beneficiaries have “special needs”?

Contact information for trust committee members and trust protector (if any)

Are electronic files backed up appropriately with strong passwords? Does the successor trustee or the attorney/CPA have the name and password in case of disability or death of Trustee?

Gather a list of the assets and liabilities with current fair market values.

If the Trust owns real estate or mineral properties, are there leases?

Are there any outstanding legal claims by or against the Trust (including any prior fiduciary)?

Are all the assets titled in the name of the trust; are there assets remaining to be transferred?

Are assets like jewelry, art, high end cars, protected and insured?

Do all the investments have proper tax cost basis and holding periods identified?

Are there non-liquid investments, have they been independently valued?

Are all life, liability, property, and casualty insurance premiums properly titled and paid up to date?

Does the trustee need to disclaim any assets?

Open a bank account in your name as “Trustee for the Trust, Dated.....”

Have ticklers or a calendar been created for critical dates?

Has a meeting with each beneficiary or beneficiaries, collectively, been scheduled?

Has a successor trustee been appointed in the event of disability or death of the first trustee?

GETTING ORGANIZED - TRUST TERMS

Read the trust carefully, ask questions!

Is the Trust domiciled in Texas? Does the Texas Trust Code apply?

Did the grantor convey the *purpose* of the Trust in the Trust or other supporting documents?

Do you understand the difference between “principal” and “income” in trust accounting and its importance in this trust?

Are the beneficiaries clearly described?

Is the distribution language for the beneficiaries clear?

Is there any non-standard investment language?

Is there retention language for specific assets?

Does the Texas Uniform Prudent Investor Act apply or is it waived?

For distributions, investments, other trustee decisions, is the direction “may” or “shall”?

Do other related trusts need to be considered regarding investments or distributions?

Does trustee have the right to resign? Before resigning, can trustee require a release?

Are there provisions for determining successor trustees if a trustee resigns, dies, becomes incapacitated, or otherwise ceases to serve?

Confirm with attorney whether this a generation skipping trust, and, if any additional steps, filings or taxes are required.

Confirm with the attorney/CPA whether any special tax provisions need attention.

Does the trust qualify as a see-through trust or conduit trust for accepting retirement benefits?

Can the trust lend to the beneficiaries or related entities, estates, or trusts?

Can the trust be a guarantor of third party loans to beneficiaries or related entities, estates or trusts?

Can trust buy from or lend to grantor's estate, other related trusts, or beneficiaries?

Is this a spendthrift trust?

Is there a provision for trustee's fees?

When does trust terminate?

If a privately held business is held, is it a Sub-S? If so, is the trust an electing small business trust ("ESBT"), a qualified Sub-S trust ("QSST"), a grantor trust, or another type of trust allowed to own Sub-S stock?

Have conditions changed since the creation of the Trust that may require modification, merger, termination or partial distribution?

MEETING WITH THE ATTORNEY

Before meeting with the attorney, read the Trust.

Discuss the purpose(s) of the Trust.

Review the trust terms and their meaning.

Verify the beneficiaries (income, remaindermen, etc.) that may require periodic statements.

Confirm whether this a generation skipping trust, and, if any additional steps, precautions, filings or taxes are required.

Check whether any special tax provisions need attention.

If any distributions are discretionary, review the process.

Annually review the investment and distribution policies.

Confirm that trustee's fees are reasonable.

If specialists for investments or other needs are required, review the need and how they are to be chosen.

Ask what a trustee's potential liabilities are in being a trustee.

If beneficiaries start indicating disappointment, discuss their concerns. Don't wait!

MEETING WITH THE CPA

Establish with the CPA a process for collecting and maintaining accurate records for income, expenses, purchases, sales and other transactions.

Determine depletion, depreciation, or other reserves for mineral/real estate or other non-standards assets.

Confirm the type of tax year for the trust, calendar or fiscal.

Confirm with the CPA the different tax deadlines for trusts and whether quarterly estimated taxes will be due.

If a privately held business is an investment of the trust, is it a Sub-S and is the trust an electing small business trust (“ESBT”), a qualified Sub-S trust (“QSST”), a grantor trust, or another type of trust allowed to own Sub-S stock?

Annually, discuss paying the annual net income from the prior year within 65 days of the end of the tax year of the trust to the beneficiaries.

If necessary to separate income and principal, confirm whether the CPA will do.

If the CPA will be preparing an audit or an annual financial statement, confirm timing.

When will the annual report be communicated to the beneficiaries?

In August each year, review transactions (year to date and planned) and discuss tax planning!

CREATING THE INVESTMENT PROCESS AND STRATEGY

Unless the trust says otherwise, the investment standard in the Texas Trust Code is that of a “prudent investor.”

Are there other investment guidelines in the trust agreement?

Determine the mix of risk assets and non-risk assets (stocks & real estate and bonds/money market funds).

Are there assets or liabilities that need particular attention - real estate, mineral properties, drawdowns from retirement accounts, privately held businesses, hedge funds requiring future capital commitments.

Are the interests of the current beneficiary to be favored over the remainderman?

Is there a need for liquidity near term or in the future? Are the liquid funds invested?

Have the tax impacts of the strategy been considered?

Are there any notable or unusual risks to any assets? Have steps been taken to mitigate?

Is there a significant concentration in any asset or type of asset? Does the Trust permit it? Are there plans for diversification?

What is the long-term investment goal of the account (growth, growth with income, balanced, income with growth, income)?

As trustee, do you have sufficient experience to manage the trust assets or do you need to hire advisors?

Will a registered investment advisor(s) be hired and will the firm accept fiduciary liability under the Texas UPIA?

Have you appropriately researched the advisor’s expertise and that their fee is reasonable?

How will performance be evaluated and what is the benchmark for each asset type?

Have the above been summarized in an Investment Policy Statement?

ANALYZING A TRUST SECURITIES PORTFOLIO

What is the long-term investment goal of the trust?

Is there an investment policy statement?

Are the assets diversified?

Is the asset allocation appropriate?

If in mutual funds, what share class? Is it appropriate?

Has the trust been actively managed?

Has investment performance been appropriately calculated?

Has a standard benchmark(s) been determined for performance comparisons?

Has the trust been managed in a tax aware manner?

Are the fees reasonable?

What are the professional designations and the experience of the investment manager?

DISCRETIONARY DISTRIBUTIONS

Critical step one:

Is this distribution in line with the goals of the trust? Have the distribution standards and purposes of the trust been discussed with the beneficiary?

Critical step two:

The trust agreement controls discretionary distributions. Discretionary distribution language in early sections of the trust may be modified by definitions in later sections of the trust agreement. Do not hesitate to ask the attorney for help.

Critical step three:

If a distribution is requested by the beneficiary, it should be in writing, stating the purpose, the amount, the date(s) needed, whether this is one or a series of needs, providing receipts, bills or estimates, and other supporting documents that you or the trust may require (budget, balance sheet, tax return, or statement of other resources or income)

Critical step four:

Is there a co-trustee who must concur?

Critical step five:

Respond and communicate without unnecessary delay.

Other considerations:

Is the beneficiary aware of the income tax implications of a distribution of taxable income?

Will the distribution be setting a standard or practice for years to come?

Will the distribution require of the beneficiary personal responsibility or financial ability to manage the funds after they are distributed?

Will this distribution be to the beneficiary or paid to someone for his/her benefit?

Is the distribution from income or principal?

Will this distribution impact other beneficiaries?

If this distribution is from principal, will this impact future income/growth of principal?

For this beneficiary, what are the distributions year to date, and for the last calendar year?

Is this distribution under a “may” or “shall” standard?

What is the size of the distribution relative to past requests and the overall size of the trust?

Are the interests of the current beneficiary to be favored over the remainderman?

Is this a fair distribution relative to the other beneficiaries or will it unduly favor this beneficiary?

In case of doubt about the standard of living, visit the beneficiary’s residence.

Is this distribution from an exempt or non-exempt generation skipping trust?

A distribution standard such as “reasonable health, education, maintenance, and support,” may be modified by any number of parameters. These can be in accordance with the beneficiary’s standard of living, with reference to the beneficiary’s other resources (the trust may require the trustee to determine these - beneficiary’s assets and liabilities, employment income and benefits, government benefits, or support obligations), and whether those other resources might have to be exhausted first.

Standards such as “comfort,” “happiness,” “liberally interpreted,” or “best interests” can be very broadly interpreted. Consult with the attorney in understanding these standards.

MEETING THE BENEFICIARIES, MANAGING EXPECTATIONS, KEEPING THEM INFORMED

If possible, have a face to face meeting.

Beforehand, let the beneficiaries know what your hopes are for the meeting and the trust.

Send the beneficiaries a copy of the trust and invite them to submit questions ahead of time.

At the meeting review the trust, **the purpose and the goals of the trust**, explaining the distribution standards, the levels of beneficiaries, the potential length of time for the trust (their lives, 100 years, etc.).

Review the investment policy statement for the trust.

Review the trust investments, their performance and the trust financial statements for the year.

Review any significant risks or issues that the trust might anticipate.

Confirm how they are to contact you (email, not text), weekdays, turnaround times, giving them notice when you are on vacation.

Remind them that if their circumstances change, financial or otherwise, they must notify you.

Document, at least, a summary of the meeting (minutes), and ask the beneficiaries to confirm.

Obtain written consent to talk with beneficiaries' lawyers, accountants, and other professional advisors and obtain permission to communicate with beneficiaries and their advisors via email.

COMMUNICATING WITH THE BENEFICIARIES ABOUT FAMILY VALUES AND WEALTH

Transferring family values is very hard (James Hughes, Family Wealth).

Start early - periodic allowances might be equally saved, shared with charity and spent.

Gradually sharing information about the family wealth creates trust.

Talk about the meaning of inheritance (James Hughes et al., The Cycle of the Gift).

TRUSTEE RISK MANAGEMENT

The goal of a well-managed trust generally is to enhance the lives of the beneficiaries. Risks, known and unknown, will always exist.

Document, document, and document.

Communicate, communicate, and communicate.

Anticipate and mitigate known future risks.

Advise beneficiaries of upcoming material changes in the investments, sale of real estate or a business, or in the administration of the trust.

When you communicate by voice, letter or email, assume that someday these may be replayed to a jury.

Before accepting the appointment as trustee, review any exculpation clauses in the trust.

If the cost of the audit is justified by the nature and extent of the trustee's transactions and/or the value of the trust's assets, consider engaging a CPA to audit the trustee's financials periodically. CPAs can often help a trustee become aware of deficiencies in internal control or weaknesses in financial systems and offer suggestions for improvement.

Purchase trustee errors and omissions insurance (if reasonably available).

Beneficiary consents, waivers and releases need to be done with full information.

Consider using Certifications of Trust to avoid disclosure of confidential trust terms to third parties (Tex. Prop. Code Sec. 114.086).

Avoid:

Comingling trust assets with your personal assets

Investing trust assets in your businesses or in deals that benefit you

Avoid your borrowing from the trust, even with reasonable interest and collateral

Buying assets from or selling assets to the trust

Unpaid taxes

Failing to obtain appropriate casualty and liability insurance

Improper investments