
FIVE STRATEGIES FOR BEING A SUCCESSFUL FAMILY TRUSTEE

*A guide to help the Family Trustee
fulfill the duties of trusteeship.*

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A GUIDE TO HELP THE FAMILY TRUSTEE FULFILL THE DUTIES OF TRUSTEESHIP.

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W E L C O M E

Being named a Family Trustee – a Trustee of a Trust created by member of your family or a close personal friend – may feel like an honor. In fact, the creator of the Trust may have intended it as one. The truth is, the Family Trustee holds a position of enormous responsibility, and a source, potentially, of enormous liability. Being a Family Trustee requires dealing with complex financial and legal issues that often involve substantial matters of judgment with profound consequences for all involved.

So while being named a Family Trustee may be an “honor,” it isn’t “honorary.” It is more like being elected to serve as the president of a small business than it is like presiding as a master of ceremonies.

But for a variety of reasons, you may find yourself serving as a Family Trustee. You may be unaware of the significant responsibilities you have undertaken, or if you are may not know how to fulfill them. Having served for over 14 years as an attorney and investment advisor to Family Trustees, as well as being personally responsible for the day-to-day administration of dozens of such Trusts, I understand the legal, fiduciary, tax, and investment responsibilities that Family Trustee. I have developed a process for identifying what those specific duties are in the context of your particular Trust, and a system intended to help make sure you are doing what you are supposed to be doing over time.

In agreeing to serve as a Family Trustee, you are rendering to your family a service of surpassing value. Here is process to help you do it right, for the best interests of you – and your family.



Five Strategies for Being a Successful Family Trustee

“You are headed for trouble if you do not have a process that identifies (1) the duties you are charged with fulfilling, (2) the legal requirements of each duty, (3) the standards for evaluating matters of judgment, and (4) a system for keeping up with changes to all of these elements.”

Before discussing the Five Strategies, there are two things that should be said at the outset to put you in the best position to faithfully discharge your duties as Family Trustee.

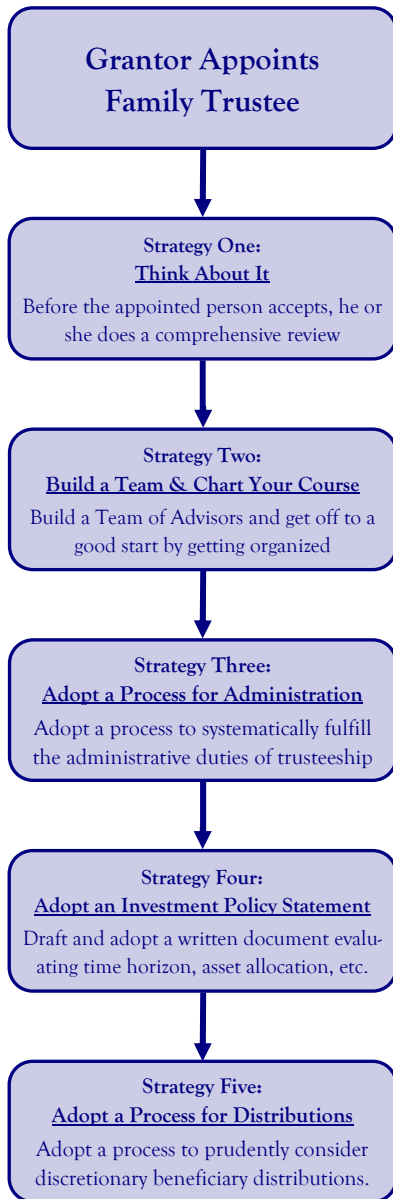
First, it is important to understand the importance of process. As a Family Trustee you are going to be responsible for a number of recurring tasks, most of which are technical in nature and any one of which you could be held to account. You are headed for trouble if you do not have a process that identifies (1) the duties you are charged with fulfilling, (2) the legal requirements of each duty, (3) the standards for evaluating matters of judgment, and (4) a system for keeping up with changes to all of these elements. This guide is intended to provide such a process.

Second, like any highly technical and specialized subject, the world of Trusts and Trust Administration has its own language. In order to be effective, it is important for you as a Family Trustee to have a working knowledge of this language. To that end, [Appendix A](#) found at the end of this guide contains a Glossary of terms and concepts relating to trusteeship with which you should familiarize yourself. Whenever terms used in this guide are listed in the Glossary they are capitalized to alert you to the fact that a definition of the term is available there.

With that in mind, let's take a quick look at the Five Strategies:

In *Strategy One: Think About It*, you understand that despite the emotions and sense of loyalty the decision may involve, serving as a Family Trustee is a choice. You take the time to ask a series of questions to give you an idea of what it is you are signing up for.

FAMILY TRUSTEE TIMELINE



The Importance of Process. The only way to manage the myriad technical responsibilities you have as a Family Trustee, and to stay out of trouble, is to institute processes that forces you to systematically review and consider, in conjunction with your Team of Advisors, all aspects of Trust Administration.



Once you have done that review and have made the decision to accept your appointment, *Strategy Two: Build a Team & Chart Your Course*, encourages you to carefully assemble a Team of Advisors, each with experience advising Family Trustees in a collaborative environment. It also encourages you, with the assistance of your Team of Advisors, to get off to a good start by formalizing in a more comprehensive way the more general inquiries you made in Strategy One.

In *Strategy Three: Adopt a Process for Administration*, you adopt a system for managing and fulfilling your administrative duties as Trustee oriented around regular meetings with your advisors, and the adoption of and adherence to “best practice” fiduciary standards.

In *Strategy Four: Adopt an Investment Policy Statement*, you design a written document setting forth among other things how liquid trust assets are to be invested and benchmarked, the relevant time horizon, and the definition of income.

Finally, in *Strategy Five: Adopt a Process for Distributions*, you implement a process for evaluating requests from Beneficiaries for Discretionary Distributions to help ensure they are consistent with the terms of the Trust document, are prudent from a fiduciary point of view, will be constructive from the point of view of the Beneficiary, be fair from the perspective of the Beneficiaries as a group, and will not imperil the long-term viability of the Trust itself.

With this overview in mind, let’s consider each Strategy in more detail.

THE IMPORTANCE OF ASKING FIRST



Sometimes Grantors create Trusts during their lifetimes that require the appointment of a Family Trustee. The advantage in this case is the Grantor can clear it ahead of time with the person he or she has in mind to serve. The prospect has a chance privately to ask questions and understand exactly what he or she is signing up for before agreeing to actually be named in the document.

However, many Trusts such as Credit Shelter Trusts and Marital Trusts come into being on the death of the Grantor. All too often the appointment comes as a surprise to the named Family Trustee, and to the family generally. He or she may see it as an honor and accept without understanding the responsibilities involved. Alternatively the named person may understand all too well the duties and potential liabilities involved but will feel obligated to serve out of a sense of loyalty to the deceased Grantor or to the family.

Asking first gives the prospect a chance to ask questions and decide prospectively whether to serve. It also gives the Grantor the opportunity to clear, or at least inform, Beneficiaries or other family members of the decision so they can ask their own questions or even express reservations while the Grantor is living.



STRATEGY ONE: THINK ABOUT IT

The fact of the matter is, just because you are named to serve as a Family Trustee does not mean you are required to serve. And even if you do accept the appointment you always have the option of resigning later. When a Family Trustee does resign, however, it is often after an unpleasant dispute with the Beneficiaries. Consequently, it is far better to take the time to understand precisely what the job entails before jumping in. So Strategy One advises you to “Think About It” first.

Ideally, the Grantor will have acquired your assent to be named prior to executing the Trust document (see **Sidebar**), but either way you need to take the time, preferably in conjunction with the Trust’s attorney, to make an educated decision whether to serve (which also gives you the opportunity to “test drive” the attorney in the event you do accept your appointment and are considering him or her as the Trust’s attorney).

So what does that mean? What do you need to know?

At the very least, you should ask and get answers to the following questions:

- What are the identities of the Beneficiaries?
- Do any Beneficiaries have particular health, maturity, or other relevant issues?
- Are you and/or your immediate family members part of a class of Beneficiaries that includes other family members (see **Case Study** on next page)?
- Are particular Beneficiaries antagonistic to you, the existence of the Trust in the first place, or are they difficult people to get along with in general?

CASE STUDY: RON*



Ron's mother died this year, and his father died several years earlier. He has a younger sister and has been named a Family Trustee of the Trust created under his parents' estate plan that has a total value of about \$1,000,000.

Ron is a successful businessman and both of his children are accomplished students and athletes who will likely attend expensive four year colleges costing a total of about \$400,000. It is unlikely either will qualify for financial aid. Ron's sister has a child with severe autism. Her husband does home renovations and has a moderate to low income with bare bones health insurance coverage. She has been forced to leave her job in order to take care of her son.

The Trust gives Ron the power to make Discretionary Distributions for the benefit of his parents' Issue subject to a Discretionary Standard: health, education, maintenance and support.

It is within Ron's discretion to make Discretionary Distributions to his children to pay for their college since it falls within the "education" element of the standard. However, it is clear to Ron that his sister's family will need a good deal in the way of distributions for the rest of their lives in order to make ends meet.

As is often the case with Family Trustees, Ron's Fiduciary Duty as a Trustee compels him to exercise his discretion impartially where it is most needed, even if it works to the disadvantage of his own family.

**See back page for important information on Case Studies.*



- Do you have the power to make Discretionary Distributions and if so is that power subject to a Discretionary Standard?
- Will the Trust be holding any difficult to manage assets such as small business interests or commercial real estate?
- How often are Accounts required to be provided to Beneficiaries and what is the mechanism for getting them approved?
- Does the Trust set forth a definition of "Income" and does it give the Trustee the power to modify that definition?
- Does the Trust document absolve you as Trustee from liability for matters involving the exercise of judgment in the absence of gross negligence?
- If you are a Successor Trustee, did the departing Trustee have the benefit of professional legal, financial and tax advice?
- If you are a Successor Trustee, does the Trust document absolve you from liability for the acts of the departing Trustee?
- If the Trust is being funded as part of an estate, is the estate being represented by an attorney and a tax advisor who have a reputation for competence and experience in this field?

With the answers to these questions in hand, and with the guidance of your advisors, you will be in a much better position to evaluate what the job will entail.

Certain facts are probably deal breakers, such as if the Trust does not absolve you as a Successor Trustee from liability for acts of a prior Trustee, or if you decide dealing with difficult Beneficiaries will be more than you are able or are willing to endure.

In other cases, serving appears less burdensome because, for example, there are few Beneficiaries or you have little in the way of discretion in making distributions.

If after gathering all of this information and giving it careful thought you decide to accept your appointment as Family Trustee, proceed to Strategy Two.

“Even in the simplest of cases, Trust administration involves complex issues of administration, taxation and investment, far more than you as a Family Trustee could hope to master on your own. Notwithstanding that fact, you are responsible for getting right — and risk personal liability if you don’t.”



STRATEGY TWO: BUILD A TEAM & CHART YOUR COURSE

Even in the simplest of cases, Trust administration involves complex issues of administration, taxation and investment, far more than you as a Family Trustee could hope to master on your own. Notwithstanding that fact, you are responsible for getting it right — and risk personal liability if you don’t.

In Strategy Two, therefore, you set yourself up for success by getting off to a good start. You do so by taking two important steps: (1) you retain a Team of Advisors with experience in Trust Administration, and (2) working with that Team, you Chart Your Path by gathering important documents and key facts about the Trust and its Beneficiaries.

Build a Team

To avoid liability as a Trustee, it is essential that you have good legal, investment and tax advice.

- Trust & Estates Attorney

In many cases the Trust you are administering is created under the estate of a deceased family member. Consequently, the selection of your Team of Advisors begins with the Trust & Estates attorney who is administering the estate. More than anyone else at this point he or she will be familiar with the Trust assets, the Beneficiaries, and the Trust provisions.

In addition to representing the estate, the attorney is often the one who drafted the Trust in the first place. He or she may have known the Grantor for years and may be able to provide the context for why certain provisions were included.

ALL TOGETHER NOW



Not only are the legal, tax, and financial aspects of Trust administration complex in their own right, each affects the other. Consequently, it is imperative that your Team of Advisors actually work as a team, that is, collaboratively, sharing information and achieving consensus on big decisions.

As described in *Strategy Three: Adopt a Process for Trust Administration*, regular meetings go a long way towards facilitating this kind of interaction. But your Advisors need to embrace that process, and not all do.

Furthermore, it is also important for someone, preferably one of your Advisors, to facilitate the collaborative process by helping to organize meetings and to disseminate relevant information. The ideal candidate is often the financial advisor since he alone among your Team of Advisors is not paid by the hour, and because you tend to have the most contact with him. He is in the best position at your direction to help you gather updated information and to help you circulate it.

For obvious reasons, it is even more ideal if your financial advisor also has a background as a Trust Administration professional, a Trust attorney, or in the best case both.



Either way, the estate's attorney is usually the obvious choice. Nevertheless, you are not required to retain that person and you need to assure yourself that he or she has the background and experience necessary to represent you adequately.

- Income Tax Advisor

Often a CPA, you need an income tax advisor with experience representing Trusts and Trustees, not only for the preparation of tax returns, but to provide tax planning advice in general. Trusts are subject to their own, often arcane, income tax and accounting rules, and it is essential to have someone with expertise in the area. Unlike the Trust and Estates Attorney, the Grantor's personal income tax advisor is often not the right person to represent the Trust. If you have already selected an attorney for the Trust, he or she can help you select an appropriate advisor.

- Financial Advisor

As with the Income Tax Advisor, the Grantor's financial advisor often is not the right choice to manage the Trust's investments. Virtually every state has laws, which in conjunction with the Trust document, mandates specific rules for managing and deploying Trust investments. And as described in *Strategy Four: Adopt an Investment Policy Statement*, having an Investment Policy Statement is essential, and you need a Financial Advisor with experience representing Trusts to help you develop one appropriate to your Trust.

- Others

Depending on the assets the Trust owns, you may need other advisors. For example, if the Trust owns life insurance, a life insurance advisor may be required. If the Trust owns closely held business interests, you may be required to retain other attorneys or income tax advisors.

UNDERSTAND THE TRUST

◆ *Beneficiaries*

- Whether any Beneficiaries are entitled to Mandatory Distributions of Income and how often.
- Whether Beneficiaries are entitled to Discretionary Distributions of Principal and when.
- Whether Beneficiaries are entitled to Mandatory Distributions of Principal and when.
- Whether any Beneficiaries have “Powers of Appointment” that override the dispositive provisions of the Trust.

◆ *Tax Status*

- If being funded as part of an estate, whether it is a Marital Trust, a Credit Shelter Trust or a GST Tax Exempt Trust.
- Whether it is a Grantor Trust whose income is reportable by someone other than the Trust.

◆ *Powers*

- Whether Trustee has power to modify definition of “Income.”
- Whether and under what circumstances Trustee can delegate responsibility for certain acts.
- If Trust has co-Trustees when they must act unanimously.

◆ *Accountings*

- How often Accountings must be made and process for allowance.

Marching Orders. The importance of understanding “what it is you are supposed to do” as a Trustee is essential.



Chart Your Path

Getting thoroughly oriented and prepared at the very beginning of your Trust Administration will set the tone for a successful (and hopefully liability free) experience as a Trustee.

So, with your Team of Advisors in place, you continue the process of “setting yourself up for success” by Charting Your Path forward with the assistance of your Team of Advisors. What you are doing at this stage is expanding on and formalizing the process you began in *Strategy One: Think About It*. It will also form the touchstone for *Strategy Three: Adopt a Process for Administration*.

Accept Your Appointment as Trustee

You only become Trustee once you have formally accepted your appointment. The Trust document sets forth the formal process for doing so usually by signing a written document.

Gather Relevant Documents

You should have copies of, and wherever possible, originals of the following documents:

- The Trust, any Trust Amendments, and Acceptances, Declinations or Resignations of Trustee.
- Any current or superseded Investment Policy Statements.
- Accounts and evidence of Beneficiary approval.
- Income tax returns and evidence of filing.
- Investment account statements and supporting documentation (trade confirmations, etc.).
- Investment management and custodial agreements.
- Investment performance reports.
- Bank records including any electronic files (e.g., Quicken).
- Meeting minutes.

JUST IN CASE



Regardless of your diligence and desire to adhere to the highest fiduciary standards in your work as a Family Trustee, you can still find yourself on the wrong end of a lawsuit with an unhappy Beneficiary. Even if the claim lacks merit, as many do in this context, it still needs to be defended, and that costs money.

Most Trusts provide that a Trustee may use Trust assets to defend the trust against all litigation and to pay reasonable attorney fees and costs from the Trust.

The best defense, in litigation or in avoiding it in the first place, is to have a prudent process in place that is faithfully followed.

However, even if you acted in good faith it is possible for the case to go against you. In that event the laws of most states, including California, say that you are personally responsible for your legal costs, which is another way of saying, you have personal liability.

Though not always available, Errors & Omissions Insurance may be an option and is worth at least considering.



Beneficiary Information

- Full name, age, address, and social security number.
- Family tree.
- Special needs or relevant personal information.

If the Trust is Being Funded as Part of an Estate

- Confirm with the estate's attorney what assets the Trust is entitled to and in what amounts.
- Obtain cost basis information for each asset.
- Obtain a copy of the estate's estate tax return (if any) to understand what elections have or have not been made, the cost basis of each asset, and to confirm that trust divisions have been done correctly.

If You Are a Successor Trustee

- Confirm that any previous Trusteeships have been terminated. If the previous Trustee died, obtain a certified copy of his or her death certificate. If the Trustee resigned, make sure you have a signed copy of the Resignation executed in the form required by the Trust.
- Communicate with entities holding Trust assets (e.g., banks, brokerage firms) to make sure they understand and agree that you have the authority to deal with trust assets and to execute any relevant paperwork.

Notifications to Beneficiaries

- Many states (including California) require that the Beneficiaries of a Trust be notified of their interest in the Trust, or of a change of Trustee.

Errors & Omissions Insurance

- You should at least look into the possibility of the availability of Errors & Omissions Insurance (see **Sidebar**).

MEETING PROCESS



Your regular meetings should have their own regular process and structure

1. All meetings should have an Agenda.
2. A Trust Inventory of Assets should be maintained, updated and reviewed at every meeting.
3. Meeting Minutes should be taken and Action Items summarized with due dates.
4. The upcoming meeting Agenda, Asset Inventory and previous meeting Minutes should be circulated to all meeting participants about a week prior to the meeting.
5. Before the end of each meeting Action Items should be summarized.
6. Within one week of the meeting, meeting Minutes and an updated summary of Action Items should be circulated for review and comment.



STRATEGY THREE: INSTITUTE A PROCESS FOR ADMINISTRATION

If you don't have a process in place to make sure everything you need to get done, gets done and correctly you are headed for trouble.

The cornerstone of your process should be regular meetings with some or all of your Team of Advisors. As a baseline, you should hold meetings at least semi-annually, with interim meetings as dictated by circumstances. In the beginning as you are getting your feet under you, quarterly meetings may make sense. Your Team of Advisors should participate as follows:

- Investment Advisor—Because of the relatively dynamic nature of investments, and the fact that you typically are not paying him or her by the hour, your investment advisor should participate in all meetings.
- Income Tax Advisor—Ideally the income tax advisor would attend the semi-annual meetings as well, though you may have more regular one-on-one contact with the advisor if quarterly estimated income tax payments are required.
- Trust Attorney—In the absence of any specific issues, meeting annually with the attorney is in most cases sufficient, assuming the attorney has provided comprehensive guidelines on how the Trust should be administered.

In terms of timing, ideally one meeting should be scheduled sometime in the mid-November to mid-December time frame in order to discuss year-end planning issues and to prepare for income tax return filing season. If meetings are being held semi-annually as the suggested, the other meeting would therefore be scheduled sometime in May.

MEETING AGENDA



A typical Agenda would take the following form:

1. Additions to the Agenda
2. Review and acceptance of previous meeting Minutes
3. Review of Action Items
4. Review of Asset Inventory
5. Review of Master Summary
6. Investment Report
7. Income Tax/Accounting Report
8. Legal Updates
9. Review of Discretionary Beneficiary Distribution requests



How often you meet and who attends will be driven in part by the value of the Trust assets. The greater the value, the greater the potential liability, and therefore greater the need for the benefit of regular expert advice.

Greater assets also means the Trust is in a better position to bear the cost of compensating professionals to attend regular meetings. Your financial advisor likely will not (and in most cases should not) charge you for regular meetings. You should expect to pay your income tax advisor and your attorney an hourly rate for preparing for and attending regular meetings. These fees can be mitigated by agreeing to meet at the income tax advisor's or attorney's office or by having either or both join by telephone.

You should have an overall Meeting Process (see **Sidebar** on previous page), and each meeting should follow a standard Meeting Agenda (see **Sidebar** on this page).

In addition, you should have a Master Summary of relevant information and documents to be shared with your Team of Advisors. It should summarize at least the following categories of information:

- Advisors—Contact and biographical information.
- Documents—Archive of all relevant documents described in *Strategy Two: Build a Team & Chart Your Course* (Trust documents, income tax returns, accountings).
- Meeting Materials— Archive of meeting Agendas, Minutes, Asset Inventories, etc.
- Investments— Archive of Investment Policy Statements, performance reports, management agreements, the links to investment prospectuses.
- Distributions— Archive of reviews of distribution requests.
- Family Tree.
- Chart of Beneficiaries and their interest in the Trust.

“The touchstone for advancing prudent investment practices is the development of an Investment Policy Statement (IPS).”



STRATEGY FOUR: ADOPT AN INVESTMENT POLICY STATEMENT

Of all the tasks you are responsible for as a Family Trustee, the Investment function can be the most problematic. This is due to the fact that in addition to being highly technical, it requires the application of a good deal of discretionary judgment. It also typically demands more of your time and attention given the dynamic nature of investments. And of course if the Trust owns assets such as commercial real estate or closely held business interests, monitoring those investments can become a full time job.

But when it comes to the investment of marketable securities, the touchstone for advancing prudent investment practices is the development of an Investment Policy Statement (IPS).

What is an Investment Policy Statement? An IPS is an agreement between you and your investment advisor setting forth the agreed upon investment model, essential facts about the Trust and its Beneficiaries that inform that model, and how its performance is to be measured over time. Here is a process for developing an IPS:

1. Confirm Investment Powers

Your investment powers come from two main sources: the Trust itself, and relevant state statutes and case law.

The Trust document always take precedence, so with the assistance of your attorney, you will need to review the Trust carefully to determine your investment parameters. Most Trusts simply include a broad grant of powers intended to give you wide latitude in dealing with investments. But sometimes unusual provisions are included and you don't want to miss them.

CALIFORNIA UNIFORM PRUDENT INVESTOR ACT

(selected highlights)

California Probate Code

§§ 16045-16054



1. Absent a contrary direction in the Trust, the Trustee has a duty to comply with the Act, and is not subject to liability if he or she relies on it in good faith.
2. Trustee should invest as a prudent investor would, considering the purposes, terms, distribution requirements, and other circumstances of the Trust.
3. Performance of individual assets to be judged not in isolation, but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the Trust.
4. Factors to be considered include: economic conditions, inflation, taxes, role of each investment as a part of the whole, expected return of income and capital, other resources of Beneficiaries, need for liquidity, preservation or appreciation of capital, and assets having special value to the Trust.
5. Trustee has duty to diversify unless prudent not to.
6. Costs must be reasonable.
7. Compliance judged by facts known at the time and not in hindsight.
8. Trustee to exercise diligence is delegating to agents and periodically reviewing their performance. No liability to Beneficiaries if delegation complies with Act.



As for state statutes and case law governing Trustee investments, almost every state has a version of the Uniform Prudent Investor Act (California's version is summarized in the **Sidebar**). This is a statute that sets forth "default rules" for prudent investment practice where not addressed by the Trust. While the relevant Uniform Prudent Investment Act creates a source of potential liability (wrongdoing is easier to prove if you violate a rule), it can also be a benefit because your actions are deemed prudent if you adhere to its provisions.

2. Determine the Investment Time Horizon

This is essential because it influences more than any other factor the appropriate Risk level in the investment portfolio, and therefore its Asset Allocation. A longer Time Horizon usually signals a higher percentage of Equity in the portfolio, a shorter Time Horizon a higher percentage of Fixed Income.

An example of a Trust with a long Time Horizon would be one whose Beneficiaries are young children who it is anticipated will not need any distributions until they are adults. The Time Horizon here is probably several decades if not longer, so a higher percentage of Equities is appropriate.

An example of a Trust with a short Time Horizon would be one where the sole beneficiary is an elderly person in poor health who needs to withdraw a large percentage of the assets every year to cover basic living expenses. The Time Horizon here is no more than about ten years and so the Trust cannot afford to take too much of the Risk inherent in Equities, and so a higher percentage of Fixed Income is appropriate.

It is generally agreed that any funds needed within five years should not be invested in Equities but set aside in cash or very short-term Fixed Income securities (see **Case Study** on next page).

Of course, the facts of most Trusts place the Time Horizon somewhere between these two extremes. Often there is one life Beneficiary who is entitled to the Trust Income, and Discretion-

CASE STUDY:

EMILY*



Emily's mother died about nine months ago, her father died several years earlier. Emily is the Family Trustee of her parents' Trust for the benefit of her parents' descendants.

Most of her mother's estate was in the Trust, and the estate owes a large amount of money in estate taxes, about half of the total value of the Trust. For a variety of reasons the Trust assets were in the form of cash soon after her mother's death.

Working with her financial advisor she determined the Time Horizon and Risk level of the assets available to the Beneficiaries (i.e., those not needed for taxes), and adopted an Asset Allocation model of 60% Equity and 40% Fixed Income.

Emily's financial advisor explained that while Equities have a higher expected return over a longer period of time, for shorter periods, especially those less than one year, returns could very well be negative. Consequently he urged her to set aside in a cash equivalent account the amount needed for estate taxes.

Emily was unhappy with what she perceived to be low interest rates on cash equivalent accounts, and decided to invest all of the Trust assets, including the tax money, pursuant to the 60/40 investment model.

Unfortunately, about six months after her mother's death, and three months before the estate tax was due, the financial markets took a catastrophic turn for the worse. In order to pay the estate tax, she was forced to sell Trust investments at a big loss which greatly diminished the funds available for the Beneficiaries.

**See back page for important information on Case Studies.*



ary Distributions of any, or even all of the Principal in the discretion of the Trustee. In that case the relevant Time Horizon would depend on whether it is anticipated that the Life Beneficiary will need Discretionary Distributions of Principal. If so, the Time Horizon will be driven by the Life Beneficiary's age and anticipated withdrawal rate. If not, then the relevant Time Horizon would be driven more by the relative ages and needs of the Remainder Beneficiaries.

As is probably apparent, this process is as much art as science. It can also change with the evolving circumstances of the Beneficiaries, which is yet another reason why you need an ongoing process that forces you to reevaluate the question at regular intervals.

3. Determine the Risk Level and Select an Investment Model

Having an understanding of the Trust's Time Horizon will point you to how much Risk it is appropriate to take in the portfolio. From a quantitative perspective, Risk is usually expressed as Standard Deviation, the statistical estimate of how variable an asset's returns will be over time (i.e., how predictable those returns are).

Many financial advisors maintain a series of model portfolios whose Asset Allocations go from the very risky (all or mostly all Equity), to the very conservative (all or mostly all Fixed Income), and moderate ones in between. With the assistance of your financial advisor, who hopefully has experience as a Trustee or at least advising them, you should be able to identify which is the best candidate for your particular Trust.

4. Test the Model

There is obviously no expectation that the Trustee be able to predict how the Trust's investment portfolio is going to perform over time. But there are resources available, in the form of computer software, that use historical returns data and statistical inference to help estimate the *probability* that a certain investment model will meet its goals over time. These do not

DIVERSIFICATION



If there is one word most associated with investing it is “diversification.” It is arguably the most important element of an investment portfolio and, in fact, for Trustees it rises to the level of a “duty.” The Trust document may absolve you of that duty in certain circumstances, but in general you do so at your peril.

What is it and why is it important?

Diversification is the process of managing Risk in a portfolio by avoiding concentrations in particular securities or Asset Classes. It can be divided into two general categories: Horizontal and Vertical.

An example of Horizontal Diversification is Asset Allocation, the selection of discrete segments of the Equity and Fixed Income markets, each having distinctive Risk and Expected Return characteristics. Using specialized computer software, a theoretically “optimal” mix can be arrived at that is estimated to provide the highest Expected Return for the appropriate level of Risk.

Vertical Diversification is achieved by selecting several or even many securities that fit within the definition of a specific Asset Class. Securities such as stocks, bonds and mutual funds are common investments which may help realize this goal.

Diversification is intended to reduce Risk that does not benefit the portfolio while leaving intact Risk which may benefit the portfolio.

However, there is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. No investment strategy, such as Asset Allocation, can guarantee a profit or protect against loss in periods of declining values.



provide an airtight “answer,” but they are a useful tool, in conjunction with other factors such as current economic conditions, in determining if the model you have selected is the prudent choice. Again, a financial advisor experienced in working with Trustees is indispensable.

5. Execute Your Investment Policy Statement

At this point you are ready to commit your IPS to writing. There are many models you can use as a starting point, but a Table of Contents might look like this:

- I. Summary and Background
- II. Statement of Objectives
- III. Time Horizon and Risk Profile
- IV. Asset Allocation
- V. Performance Benchmarks
- VI. Trading Procedures
- VII. Rebalancing of Strategic Allocation
- VIII. Custody
- IX. Duties and Responsibilities
- X. Notification of Substantial Changes
- XI. Modifications to Investment Policy Statement
- XII. Acceptance of Investment Policy Statement

GOOD COMMUNICATION AND DOCUMENTATION

Your Best Defense



- Good Communication

Perhaps the biggest reason Beneficiaries sue their Trustees, regardless of the merit of the claim, is poor communication on the part of the Trustee. It is required by law in many states, including California (e.g., duty to keep Beneficiaries “reasonably informed” of the Trust and its administration, the duty to account, the duty to provide a copy of the Trust document to the Beneficiaries). But it helps to avoid misunderstanding and the feelings of neglect that fuels so much Trust litigation.

- Good Documentation

If despite your best efforts you do find yourself in court, one of your best defenses is a thorough written record. Good documentation not only provides evidence to counter beneficiary claims, it demonstrates the high level of diligence and dedication that the court expects. Poor documentation can bias the court against you regardless of the merits of claims involved.



STRATEGY FIVE: ADOPT A PROCESS FOR BENEFICIARY DISTRIBUTIONS

Trusts benefit Beneficiaries, and the main way they benefit is through Distributions. Some Beneficiaries are entitled to Mandatory Distributions, for example a surviving spouse may be entitled to receive the Trust’s “net income” annually. In that case all that needs to be done is to calculate, with the assistance of your income tax advisor, the net income each year and make sure the Beneficiary receives it as specified in the Trust document.

Discretionary Distributions, however, are an entirely different matter. These require you to exercise judgment in situations where there is often no “good” answer. It may also require saying “no” from time to time, which for a Family Trustee, can strain or even damage his relationship with the Beneficiary.

When it comes to Discretionary Distributions, judges are reluctant to substitute their judgment for that of the Trustee. When a judge does, however, it is often because of one of two reasons: (1) he or she feels the Trustee’s communication with the Beneficiaries has been inadequate, or that (2) because of poor documentation the Trustee is unable to demonstrate that he acted prudently, even if he in fact did (see **Sidebar**).

As with all other aspects of Trust Administration, in order to manage Discretionary Distributions prudently, and hopefully keep yourself out of court, you need to adopt a process. The outlines of such a process might look like this:

- Understand the Terms of the Trust

It is important to understand precisely what discretion you are provided under the Trust document, what standards, if any,

CASE STUDY: JOHN*



Several years ago John became the Trustee of a Trust created by his parents for the benefit of his brother James who was ten years younger. According to the Trust, once James turned 18, John as Trustee could make Discretionary Distributions in his “uncontrolled discretion.”

James recently turned 18. He always intended to go to college and had the grades to get into a top school. When the time came, however, James and some friends he started a band with decided they had what it took to make it big in the music business. They had no doubt they would all be famous and wealthy within a few years. All they needed was some “startup capital” to get things going.

James explained the plan to John and asked for a Discretionary Distribution of the entire Trust estate. John always believed in people “pursuing their dreams” and agreed.

A year later things didn’t quite work out for the band, and all of the money was gone. Several years later James realized how naïve and foolish it was for him to forego college to pursue a career as a rock star. He would like to go to school now but has little money of his own. He is eligible for some financial aid but if he goes to a top school he will be saddled with many thousands of dollars of debt.

If James wanted to pursue it, John very well could be held liable for a breach of fiduciary duty. Even though his discretion was “absolute and uncontrolled,” he still had a duty to exercise his discretion in a way that was prudent.

**See back page for important information on Case Studies.*



bound that discretion, and the class of Beneficiaries eligible for such distributions.

Sometimes Grantors have specific ideas on how Discretionary Distributions should be made, but are reluctant to formalize them in the Trust document itself in order to give the Trustee the flexibility to adapt to changing circumstances. One alternative Grantors sometimes resort to is to write a “side letter” describing what they had in mind in terms of Discretionary Distributions (priorities, types, timing, etc.). Such a letter is not legally binding on the Trustee, but can provide not only helpful guidance in making Discretionary Distributions, it can provide a kind of “moral cover” since family members are usually reluctant to challenge the Grantors’ stated wishes, regardless of whether or not they are legally binding.

- **Understand the Scope of Your Discretion**

The Trust document may limit the Trustee’s power to make Discretionary Distributions to a standard. For example, the Trust might provide that Discretionary Distributions may be made for the Beneficiaries’ “health, education, maintenance and support.” Each of these terms may have a specific legal meaning, so it is important to make sure your attorney provides guidance on what the terms of the standard actually mean.

Another standard often seen in Trust documents is to support a particular Beneficiary in his or her “accustomed manner of living.” The difference is important. A standard that limits Discretionary Distributions to “support” probably would not justify a distribution to cover an around the world luxury cruise, whereas an “accustomed manner of living” standard very well might if it was consistent with the Beneficiary’s “accustomed” lifestyle.

Finally, the Trust may describe your discretionary authority as “absolute” or “uncontrolled.” Be careful not to take these words too far. The standard duties of prudence always apply, it isn’t a free pass to do whatever you want (see **Sidebar**).

*“It is hard to
overstate the
value of having
happy
Beneficiaries.”*



- **Whether Certain Beneficiaries Should Be Preferred Over Others**

Some Trusts describe a general class of beneficiaries, but indicate that preference should be given to one or more. An example is a Trust that provides “for the benefit of my husband and issue, but special preference shall be given to my husband even if doing so exhausts the Trust estate during his lifetime.” In this case, what qualifies as a “prudent” Discretionary Distribution to the husband is broader than what would be prudent to “issue.”

- **Develop a Process for Evaluating Beneficiary Requests**

In cases where a large class of Beneficiaries is eligible for Discretionary Distributions, the decision of whether or not to approve a distribution request will require balancing a number of different factors. For example:

- ◆ Does the Beneficiary have other available resources that should be taken into account?
- ◆ Does the Beneficiary have a risk of creditors (e.g., works in a high risk profession, is in bankruptcy, or has or is in danger of having a failed marriage) such that an outright gift might end up in the hands of someone other than the Beneficiary?
- ◆ Is the Beneficiary eligible for distributions from other Trusts whose tax attributes are more beneficial?
- ◆ Will granting the requested distribution compromise the ability of the Trust to meet the future needs of the other Beneficiaries?
- ◆ Would a loan as opposed to an outright distribution be a better option under the circumstances?

It is good practice to require that all Beneficiary requests be made in writing, and to document your thought process in approving or denying the request. It is also important to respond to all requests in a timely manner. It is hard to overstate the value of having happy Beneficiaries. If there is one thing that aggravates Beneficiaries the most it is being ignored, especially if the ultimate response to their request is negative.

“Trust administration is a complex and highly specialized field, and you can’t do it without the assistance of professionals with the right kind of highly specialized expertise and experience.”



Your Next Steps

The decisions you make as a Family Trustee can have profound consequences for your family. If done poorly, those consequences can be quite negative. But if done right, you are in a position to provide an invaluable service to your family whose positive impacts may benefit numerous individuals for generations.

The Five Strategies described here can go a long way towards doing it right. But if you have gotten this far, it should be apparent that you can’t do it right and do it alone. You need the assistance of a Team of Advisors, professionals in the legal, tax and investment arenas (and sometimes others) who have experience representing Family Trustees. Trust Administration is a complex and highly specialized field, and you can’t do it properly without the assistance of professionals with the right kind of highly specialized expertise and experience.

It is also highly beneficial, if possible, if one of the professionals can take the lead in helping you to manage the process. Under the law you cannot actually delegate that responsibility, but having a “buddy in the trenches” so to speak to support you can help you keep your eye on the ball and help ensure your advisors are working collaboratively. Any of your professionals can serve this role, but if there is one who has experience in more than one of these professional areas, so much the better. Because you tend to see your financial advisor most often, and he usually does not charge by the hour, he often is a good choice if he or someone in his office has experience working with Family Trustees.

So if you are serving, or are considering serving as a Family Trustee, you owe it to yourself and to the Trust Beneficiaries to take the time to do it right.



Appendix A: Glossary

I. The Basics

- A. Trust – A legal document whose most essential feature is that it separates the legal ownership of trust assets (held by the Trustee) from the beneficial enjoyment of trust assets (held by the Beneficiaries). Sometimes referred to as Declaration of Trust, Agreement of Trust or Indenture of Trust.
1. Trust Amendment – A legal document which supersedes and modifies a provision in the original Trust document and becomes an integral part of it. If the Amendment revokes every single provision of the Trust and replaces it, it is known as a Comprehensive Amendment or a Trust Restatement.
- B. Grantor(s) – The person or persons who create the trust. Also known as the Donor(s) or Trustor(s).
- C. Trustee(s) – Person or Persons who hold legal ownership of trust assets to be administered according to the terms of the Trust document for the benefit of the Beneficiaries.
1. Family Trustee – A non-professional family member or close friend without specific expertise as a Trustee who usually serves for no fee or at a lower fee than a Corporate Trustee.
 2. Corporate Trustee – A professional individual (known as a private fiduciary), or an entity (such as a bank or trust company) that is in the business of serving as a Trustee for a fee.
 3. Successor Trustee – The Trustee named or appointed to succeed to the office of Trustee after the existing Trustee has either died or resigned.
- D. Beneficiary(ies) – Person or persons who are entitled to the benefits of the trust, receiving Mandatory or Discretionary Distributions of either Trust Income or Trust Principal.
- E. Fiduciary – A person holding a position of trust and confidence to act primarily for another's benefit in matters connected to that position. Examples include Trustees, Executors or Guardians.
- F. Fiduciary Duty – Consists of a number of separate duties, including (in California):
1. Duty to Administer the Trust – The Trustee has a duty to administer the trust *according to its terms*.
 2. Duty of Impartiality – If there is more than one trust Beneficiary, the Trustee cannot unduly favor one over the other, even if that impartiality is not in the best interest of the Trustee or his or her family as beneficiaries.
 3. Prudent Person Rule – The Trustee is required to “administer the trust with reasonable care, skill, and caution under the circumstances.” In essence it means that the Trustee needs to administer the trust in a good businesslike way employing qualified professionals in areas the Trustee does not have skill or expertise.



4. Discretionary Powers – The Trustee must exercise any Discretionary powers fairly. Just because the Trust document gives the Trustee “uncontrolled” powers does not give the Trustee license to act in bad faith. He or she always has an overarching duty to further the purposes of the Trust.
- G. Account – A precise summary of financial activity in the Trust for a specific period of time, usually a year. It must be in a specific form that accounts for Income and Principal separately.
1. Assent – A signed acknowledgement by a Beneficiary that he or she has had the opportunity to review an Account from the Trustee and that he or she has no objection to it and waives any future right to object.
- II. Types of Trusts
- A. Revocable Trust – A Trust that can be amended or revoked at any time in the discretion of the Grantor (person creating the trust). As a practical matter it has no functional independence from the Grantor and the trust assets are treated as if they were owned outright by the Grantor. Assets are titled under the Grantor’s social security number and all Trust income is reported on the Grantor’s personal income tax returns.
 - B. Irrevocable Trust – A Trust that cannot be revoked by the Grantor. It has its own legal significance independent of the Grantor, has its own taxpayer identification number, and files its own income tax returns.
 - C. Testamentary Trust – A Trust created under a Will on the death of the Testator (the person executing the will). An archaic form of trust rarely used today.
 - D. Grantor Trust – An Irrevocable Trust over which the Grantor retains certain powers such that the Trust Income is reportable on the Grantor’s personal income tax returns regardless of the fact that the Trust has independent legal significance and files its own income tax returns.
 - E. Marital Trust – A Trust funded as part of an estate that qualifies for the estate tax marital deduction in the decedent’s estate. In order to qualify the only Beneficiary can be the surviving spouse.
 - F. QTIP Marital Trust – A common form of marital trust (“Qualified Terminable Interest Property” Trust) in which the surviving spouse is entitled to all of the Trust income annually.
 - G. Credit Shelter Trust – A Trust funded as part of an estate that represents the decedent’s unused estate tax lifetime exemption amount. The class of Beneficiaries usually includes the surviving spouse and the decedent’s Issue.
 - H. Generation-Skipping Transfer Tax (GST) Trust – A Trust funded as part of an estate that represents the decedent’s unused GST Tax exemption. The class of Beneficiaries usually includes the decedent’s Issue.
 - I. Special Needs Trust – A Trust designed to provide supplemental benefits to a person receiving Medicaid because of a disability of some sort but that do not cause that person to become ineligible for those benefits.



III. Beneficiaries

- A. Life or Income Beneficiary(ies) - The person or persons who are entitled to benefits during their lifetimes. Often they are entitled to receive the net income of the trust and may receive Discretionary Distributions of Principal in the discretion of the Trustee.
- B. Remainderman(men) - The person or persons entitled to Trust benefits when the Income Beneficiaries are all deceased. During the lifetime of the Income Beneficiaries they may be entitled to distributions in the discretion of the Trustee.
- C. Issue - The descendants of the Grantor (children, grandchildren, great-grandchildren, etc.)
- D. By Right of Representation or Per Stirpes - A common family dispositive scheme, as in, “to my Issue by Right of Representation.” It means that if one of the Grantor’s Issue predeceases the Grantor, his or her children (or grandchildren as the case may be) step into the deceased person’s place. For example, if the Grantor has three children, each of which have two children, if one of the children predeceases the Grantor the predeceased child’s children share the portion their parent would have received (i.e., the two surviving children would receive 1/3 each and the children of the predeceased child share their parent’s 1/3, or 1/6 each.

IV. Distributions – Transfers out of the Trust to or for the benefit of Beneficiaries

- A. Mandatory Distributions - Distributions that the Trust document requires the Trustee to make (e.g., “pay Beneficiary A the net income of the trust at least quarter annually”).
- B. Discretionary Distributions - Distributions that the Trustee may make to or for the benefit of Beneficiaries in his or her discretion.
 - 1. Discretionary Standard - Sometimes the Trustee’s discretion is limited by a standard (e.g., the Trustee may make distributions of principal in his or her discretion for the Beneficiary’s “Health, Education, Maintenance or Support”, or in his “accustomed manner of living.”)
- C. Income - Trust “earnings” that the Life or Income Beneficiary is typically entitled to, historically defined at interest and dividends.
 - 1. Total Return or “Unitrust Amount” - An alternative definition of Income that defines income as a certain percentage of the Trust assets.
- D. Principal or Corpus - The assets of the Trust not including Income that the Life Beneficiaries are typically entitled to in the Discretion of the Trustee, with anything remaining to the Remaindermen on the death of the Life Beneficiaries.



V. Fiduciary Income Tax

- A. Fiduciary Income Tax Return—Income tax return filed by the Trustee of an Irrevocable Trust reporting items of trust income and deduction.
- B. Federal Form 1041 - The Federal Fiduciary Income Tax Return.
 - 1. Federal Form K-1: A form filed as a part of Form 1041 and given to a Trust Beneficiary indicating which items of Trust Income and/or Deduction must be reported on the Beneficiary's personal income tax returns.
- C. California Form 541 - The California Fiduciary Income Tax Return.
 - 1. California Form K-1 - The California version of the Federal Form K-1.

VI. Investments

- A. Investment Policy Statement—A formal document signed by the Trustee and his or her investment advisor setting forth pertinent information about how liquid assets are to be invested and monitored.
- B. Risk—The chance that an investment's or portfolio's return will be other than what was expected. As time goes on, it is more likely that the return of an asset will approximate its expected return, so higher Risk is more appropriate for longer investment Time Horizons. It is usually expressed by the statistical measure of standard deviation.
- C. Return—The gain or loss on an investment over time consisting of capital gains and income.
- D. Asset Class—A segment of the investment universe that has particular and usually unique Risk and Return characteristics. Examples include large cap, small cap, growth, value, domestic (US), international, emerging markets, short- mid- and long-term fixed income, and high-yield fixed income.
- E. Asset Allocation - The mix of Asset Classes that is intended to provide the highest expected return for a target level of portfolio Risk.



Mark joined Genovese, Burford & Brothers in 2010, a fourth-generation Sacramento native returning after 25 years living in Massachusetts and Virginia.

He graduated from Williams College in Williamstown, Massachusetts, in 1988, with a B.A. in History, and earned his J.D. from the Washington & Lee University School of Law in 1997. Mark is a CERTIFIED FINANCIAL PLANNER™ certificent.

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Five Strategies for Being a Successful Family Trustee

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