E. Importance of Documenting the Decisions

1. To be held liable for a discretionary decision, a court would have to find that the trustee abused his discretion

2. Trust must insure that his file is well documented

    a. Written request for distribution
    b. Invoices, receipts – consider paying the bill directly from the trust
    c. Budget, income and expense statement, financial statement
    d. Calculation of power to adjust amount

V. Recognizing that professional trustees are not appropriate for every trust situation, however, individual trustees must conduct there fiduciary activities within the terms of the governing instrument and the provisions of the applicable governing law. Many laymen are not aware of the duties and responsibilities, as well as the personal liability, associated with serving as trustee.

principal if the adjustment does not reduce the net income below 5% of the fair market value of the trust at the beginning of the year.

2. Many corporate trustees calculate a “standard” rate each year based on market conditions – usually 2.5-3% - and apply that percentage to a rolling average of, say,, that last three years’ beginning market values in order to take the peak and valleys out of the distribution

3. The purpose of exercising the power to adjust is to insure the trustee is satisfying his duty to be fair and reasonable to all beneficiaries, NOT to meet the income beneficiary’s needs

C. Discretionary Power to Allocate Receipts and Disbursements

1. LA R.S. 9 2142-2157 are the default rules when document is silent

2. What if the document gives the trustee the authority to allocate receipts and disbursements to income, principal are partially to both?

3. In exercising discretion to allocate, the trustee must be fair to all beneficiaries

4. Many corporate trustees allocate according to the state law default rules when given the discretion, and if there is a reason to allocate differently, there is an approval process much like the discretionary distribution approval process

D. Discretionary Termination

1. Are there conditions in the governing instrument?

    a. Under a certain size?
    b. Uneconomical to continue
    c. At any time after a certain age
    d. In the best interest of the beneficiary

2. Age and demonstrated financial maturity of the beneficiary

3. Fees and expenses as a percentage of the market value or income

4. Is there still a need for the trust, but maybe with a different trustee? Resignation rather than termination?

IV. Exercising Discretion

A. Distributions

1. Objective standards such as health, education, maintenance and support (HEMS)

    a. Support is something above mere subsistence level of support
    b. Would elective procedures such as a "face lift" be included in health?
    c. Does education include primary and secondary private school tuition?

2. "May" vs. "Shall"

3. Must the trustee consider other resources?

    a. Trust instrument may require that the trustee consider or resources
    b. Trust instrument may state that the trustee may consider other resources, but is not require to do so
    c. Trust instrument may be silent
    d. If required to consider other resources, the trustee should not require that the beneficiary exhaust all resources before receiving a distribution from the trust

4. Accustomed standard of living

    a. When?
    b. What if the trust assets are not significant enough to keep the beneficiary in his or her accustomed standard of living?

5. Broad subjective standards such as comfort, happiness, best interests

6. Is there language to favor one beneficiary over another?

7. What is the size of the request as a percentage of market value of the trust assets?

8. When does the trust terminate? What is the stated purpose of the trust?

B. Power to Adjust

1. Statute allows an adjustment of an amount from principal to income if the amount when added to the net income does not exceed 5% of the fair market value of the trust at the beginning of the year, or from income to

f. Tuition, books, tutoring
g. Pre-paid funeral expenses

10. If there is significant money, it may be best NOT to create a special needs trust because of the limitations.

11. Because of the specific set of rules governing special needs trusts, some corporate trustees have created specialized administration units to handle the administration of SNT's.

III. Specific Risks Associated with Certain Trust Assets

A. Real Estate

1. Commercial property management
2. Farm and ranch expertise
3. Residential property management
4. Adequate insurance and payment of property taxes
5. Lease negotiations
6. Sale negotiations
7. Timber management
8. Environmental considerations
9. Valuation/appraisal
10. Consider holding asset in a single member LLC or other type of entity rather than direct title in order to protect the other assets of the trust from liability exposure.

B. Minerals

1. Allocation of mineral receipts to income and principal (depletion)
2. Lease negotiation
3. Working interests management
4. Farm out agreements, seismic testing

C. Closely Held Businesses

1. Valuation/appraisal
2. Compliance with by-laws or operating agreement
3. Management
4. Tax compliance
5. On-going business management
6. Negotiation of sales

even if it does cause a reduction in benefits. The Trustee must document the decision with well thought out notes to the file, etc.

2. No self-dealing – may be difficult when the trustee is family member. Can a family member serve as trustee and also as a paid companion/sitter for the beneficiary?

3. Be careful of having funds paid directly to the beneficiary as this may reduce SSI benefits. Instead, pay bills for the beneficiary.

4. Many times the Trustee is faced with the practical problem of getting expenses paid. Best method is to have the beneficiary or family member charge allowable expenses on a credit card and then the trustee can pay those expenses directly to the credit card company. What if there is a credit issue and no one can qualify for a credit card?

5. Avoid paying the beneficiary's housing and food related expenses, if possible.

6. Beneficiary occupied residence can be owned by the trust and considered as an investment rather than housing expense. This, however, can create other issues.

    a. If the beneficiary is a minor, the home is typically occupied by the beneficiary and his/her family. Do you charge the family rent?
    b. If you justify not charging rent while the beneficiary is a minor, what about when the beneficiary obtains the age of majority?

7. The trustee must know what public benefits programs assist the beneficiary and the trustee must know the rules for those benefits.

8. Balancing current wants and needs with future wants and needs

9. Types of expenditures that may be allowable (some are allowed under federal guidelines, but not under some state guidelines – trustee must be mindful of both)

    a. Clothing
    b. Computers, televisions and electronics
    c. Travel (be careful of refundable airline tickets as these can be converted to cash)
    d. Durable medical equipment (some states determine if it is "necessary")
    e. Care management (some states limit what can be paid to family members)

agent. Trustee must understand the different types of product available – non-guaranteed, no lapse guarantee, interest-driven, investment-driven, etc.

6. When faced with the decision whether to continue a policy, there are several options that the trustee may take and the trustee must document its decision.

   a. Hold until death with out-of-pocket or cash value payments, which may involve the trustee:

      1) Doing nothing
      2) Converting the policy
      3) Purchasing paid up with reduced death benefit
      4) Extending the term
      5) Entering into a 1035 exchange

   b. Lapse or surrender

   c. Borrow cash to pay premiums (from family members, beneficiaries, commercial lender)

   d. Sell to a third party in a life settlement

7. Grantors generally do not want to pay corporate trustee fees for ILIT's – after all, the only thing the trustee does is accept a donation each year, write the Crummey letters and pay the premium, right? Wrong!

8. Administering ILIT's require specialized expertise. Many corporate trustees no longer accept ILIT's or, alternatively, have set the bar quite high as to their acceptance process (for example, only for existing clients with significant other business, minimums for face amount of policies, minimum cash donations, adequate fees for the risk taken etc.)

B. **Special Needs Trusts (SNT's)**

1. Following the terms of the trust instrument – can be challenging as sometimes the terms of the trust instrument cannot be reconciled with the reality of the situation. For example, "supplement but not supplant public benefits" and "use the trust property in ways that will best help the beneficiary to lead a comfortable and fulfilling life." Let's say the beneficiary is receiving SSI, but truly needs better housing. If the trust pays for housing, it may reduce the beneficiary's SSI benefits. Depending on the size of the trust and the circumstances, it may be the right thing to do – provide housing

6. Insurance – trustee errors and omissions coverage, fidelity bond, etc.

7. Annual administrative and investment reviews

Disadvantages of a professional trustee

1. Fees – however, the trust may pay more with an individual trustee in the form of investment management fees, accounting fees, specialty assets management fees. No one should expect a trustee to serve for free.

2. Today's banking environment – perception of no "hometown" banks

3. Inflexibility and red tape – "Professional trustees do it by the book".

II. Specific Risks Associated with Serving as Trustee of Certain Types of Trusts

A. **Irrevocable life Insurance Trusts (ILIT's)**

1. Life insurance is a complex trust investment and requires special attention. It is no longer a "buy and die" proposition. An ILIT Trustee should be able to answer these questions at any time:

   a. How is the policy performing relative to expectations?
   b. When was the last time the policy was reviewed?
   c. Are there policies in the marketplace that may do a better job of meeting the grantor's wishes?
   d. Has the credit rating of the insurance company that issued the policy deteriorated?
   e. What alternatives are available in the existing contract should the current funding arrangement be discontinued for any reason?

2. Most ILIT trust instruments have a Crummey provision. Does the individual trustee know that the notice must be sent each time a contribution is made and the potential consequences if the notices are not sent?

3. Failure to pay the premium when due.

4. Failure to review the so-called "vanishing" premium policies.

5. Trustee's role and responsibility in policy acquisition is very important. The decision as to policy selection rests with trustee just like any other investment. Trustee cannot blindly rely on grantor and his/her insurance

SO, AUNT SALLY WANTS TO BE TRUSTEE…

CHARLOTTE K. RAY
MANAGING DIRECTOR
JPMORGAN CHASE BANK, N.A.

I. Individual vs. Corporate Trustee

A. Individual trustee

Family member or trusted friend – do they have expertise in fiduciary law, investment management, etc. Are you setting them up for a bad relationship with the beneficiaries, or worse, a conflict of interest? Can they obtain insurance that would cover errors and/or omissions, etc.? Expertise in specialty asset management – real estate, minerals, closely held companies. Do they realize that they have personal liability for breaches of fiduciary duty? Do they understand the provisions of the trust instrument? (Have they read the trust instrument?)

A Professional – Attorney or CPA - Many professionals draft excellent documents and provide excellent planning advice. However, many have very little experience in actual trust administration. Does their professional liability insurance cover fiduciary activities?

B. Corporate trustee

Advantages of a professional trustee

1. Availability and continuity

2. Expertise – investments, accounting & record-keeping, taxation, fiduciary law, specialty assets management such as real estate, oil & gas, closely held businesses

3. Objectivity – can just say "no", personal emotions are not involved, can balance the duties owed to income and principal beneficiaries, duty of impartiality

4. Regulation – internal auditors, regulatory agencies

5. Standardized policies, procedures and processes