

FDIC PRESENTATION

Have You Ever Talked to a Beneficiary?

Case Study

- a) Anonymous.
- b) Beneficiary requests conversion prior to enactment – converts to ‘similar to a unitrust’ 2001
- c) All provisions same/4%, averaged 3 years, remainders approve, no factual basis, beneficiaries right. Never called when rationale passed.
- d) Market declines – 16M → 7M / bank denies unitrust, mortgages. Value still well above inception value.
- e) Request \$ for 5 grandchildren’s education – ok but must see financials – NO!
- f) Co-trustee (bank ‘co-counsel’) says too heavy a drain on trust this size.
- g) 4% → 3½%; mortgages out. No discussion. Retains mortgages for fee purposes.
- h) Argues not a unitrust, but what legal basis? Ascertainable standard v. uni model. Was a uni because no basis required, kids approved, averaging 4% ongoing support rather than a specific need. Contract.
- i) Argues against uni, favors ascertainable standard despite not designed as well – savings benefit husband. Yet he invests better.
- j) Argues conflict with remainders.
- k) Now offers 5%, no mortgages. He stand firm.
- l) Point arguments not well founded – merely made negotiations more time consuming, expensive. Would offer 4% uni to new client with 7M if requested. What’s the difference? Bank advantages its deep pocket, control over assets, delays concession to 5% until petitions/affidavits prepared. Hostility issues – better if had frank discussion.

Introduction

- a) Ever talked to a beneficiary? Why not? Limited to enforcement of regulatory provisions, keep bank solvent.
- b) Need for greater communication – many important issues not obvious like to recruit the auditor as an ally.
- c) Will cover issues related to investing, costs, distributions, and the beneficiary-trustee relationship. Over the years since 1991, 2500+ beneficiaries complain but presumably most don’t bother because not informed.
- d) Some issues which appear to violate fiduciary principals may be sanctioned under local law. Important issues may not be apparent from an accounting statement. Most issues have been raised by beneficiaries at one time or another; others are issues which deserve to be red flagged. In any event, please remember as we move from issue to issue that a corporate trustee is a fiduciary bound to administer at a level beyond that of the individual trustee and is required to put the beneficiary’s interests ahead of its own. Most importantly, note that for practical purposes beneficiaries are powerless, virtually dependent on the good offices of the trustee.
- e) A detailed case analysis of one trust available for inspection. Will have copies of talk

plus other literature available at conclusion if of interest.

Investing Trust Assets

A. General Concerns

- a) Did (does) bank make available to the settlor/beneficiary a review of its investment performance as compared to standard indices? Low cost index fund offered if not good? Why is it said ‘big money’ avoids banks?
- b) The adage – “as the stock market goes, so go fiduciary assets”. But not always – in 2009, “the average asset growth... was 9%, well below the DJIA’s robust 19%.”
- c) Apparent focus on managing risk to bank rather than maximum productivity; tendency to over-diversification – small positions in large number of issues over multiple sectors instead of focusing on a few growth areas. Economical and convenient because limits exposure if one issue goes south; ignores fact large cap companies are often internally diversified and that inclusion of proprietary or other funds in portfolio adds additional diversification.

B. Some specific investment issues (not exhaustive)

- a) Use of proprietary funds – how justified under Prudent Investor?
- b) All investments productive in capital gains/yield including real property other than homestead?
- c) Writing options for additional income?
- d) Comparing discretionary vs. non-discretionary portfolios – why should they differ in makeup, performance?
- e) Date last portfolio review? Criteria?
- f) Ratio of analysts to size of master list reasonable?
- g) Investments in companies controlled by the trustee?
- h) Securities held by bank in its own investment portfolio offloaded to personal trust accounts?

Cost/Fee Issues

A. General Concerns

- a) Can’t effectively contest fee rates because ultimately bank can litigate at no cost (Bacot, prior BNY CEO – ‘pricing inelastic’). Corporate trustee has conflict because compensated; this fact reflected by rate increases, termination/tax prep/sweep fees and/or class action/legal surcharges on proceeds not authorized by settlor, willingness to resign if trust small but fight hard if large. Example: bank successfully contested class action concerning sweep fees but then tried but failed to surcharge beneficiaries’ account for its legal costs (Upp plaintiff v. Mellon). *Trust Updates* currently reports “1 in 4 fiduciaries plan to raise fees, especially banks with under 1 billion in assets. Average 2% annually.” How justified?
- b) Is there a fee rate agreement with the trustee/co-trustee agreed to by the settlor? By the beneficiary? If not, what rationale exists to increase rates? “For 2010, better than 1 in 4 fiduciaries ... say they plan to raise fees.”
- c) Administration fees uniform for all other trust, estate clients?
- d) Does an agreement offer remedies provided fees not acceptable? If contested, does trustee have burden of showing reasonableness sans a petition by the beneficiary?
- e) If no fee rate agreement, is rate set by a standard fee schedule and is that schedule

- dated and the same as currently offered to a settlor? Other beneficiaries?
- f) Are rates competitive with fees charged on non-discretionary accounts and, if not, why not? Risk different?
 - g) Are fees same for trusts with vs. w/o a removal clause?
 - h) Are fees aggregated on multiple accounts set up by same settlor?
 - i) What percentage of income do fees consume? Is there evidence that fee rate \ encouraged inappropriate use of bonds?
 - j) Does the bank act as agent or principal in brokerage transactions; if using in-house brokerage, are fees competitive and uniform to all clients?
 - k) How are brokerage fees calculated e.g. include 12 b-1 fees? Shown on accounting statements?
 - l) Does bank show administration fees in terms of basis points on accounting statements?
 - m) Are imbedded fees in proprietary funds rebated?
 - n) Appraisals on real property current and realistic if used included in fee base?
 - o) Is bank demanding fees not authorized by the instrument? E.g. termination fee, tax letter fee, sweep fee?
 - p) Is bank demanding a release in lieu of imposing costs of a final court accounting?

Distributions

- a) Has bank offered conversion to a unitrust?
- b) Has bank held up distribution of assets at termination until release is signed, possibly otherwise threatening to impose costs of a formal court accounting?
- c) Has bank invaded a beneficiary's privacy by demanding a budget/tax return prior to making a distribution under an ascertainable standard even if not required to do so by statute? Inquired into alternative sources of income?
- d) Has bank asked for concessions prior to approving a distribution of principal under an ascertainable standard?
- e) Personal example (Mellon/BNY vs. Smith)

The Trustee-Beneficiary Relationship

- a) Be aware that irrevocable trust accounts often don't have removal clauses, particularly older instruments. The fact that the corporate trustee typically has sole signatory control over the trust assets effectively gives the corporate trustee added leverage (now under law in NY?). Even with clause, bank may still contest thus requiring beneficiary to find independent, affordable, competent counsel and risk that trustee's defense costs will be assessed against the trust. Co-trustee of little help because corporate can always veto forcing beneficiary into court. Some times only defense is publicity and that fact is of limited usefulness. Used to recommend litigation – now advise to play the 'good will chip'. Does a corporate trustee always act in the best interest of the beneficiary? It looks that way on paper but the reality is different. 'In loco parentis' a great phrase but not realistic. Nevertheless need the corporate fiduciary because individual trustees sometimes steal but a corporate should be a partnership between trustee and beneficiary rather than one of monopolistic control. Attitude that is the bank's money and that bank is always assumed to be

- correct, symptomatic of poor relationship.
- b) Beneficiaries are essentially powerless especially if no removal clause but sense keenly of bank's control of beneficiaries' finances; may resent settlor, bank for tying up family money without their consent. Often afraid to confront trustee that may control only source of family income. Negotiations can be frustrating, discourage beneficiaries from raising issues. Banks will 'circle the wagons' if confronted. Have the advantage of deeper pockets, experienced representation and have control of assets so no need to settle promptly. If removal clause in place, may still contest or work to please beneficiary (*Bessemer* case). In a recent decision of the Supreme Court restricting the *Miranda* decision, Steven Shapiro, Legal director for the American Civil Liberties Union, commented that the *Thompkins* case "demonstrates the power of custodial interrogation to wear down (a) defendant's willpower." There is a parallel, I believe, because a beneficiary of an irrevocable trust lacking a removal clause is almost powerless, entrapped as it were in the financial custody of the trustee, a fact which colors any attempt by a beneficiary to negotiate issues. Yes – there can be an exchange by mail – or more usually by phone – but beneficiaries can not expect a prompt, responsive reply.
 - c) Has bank threatened a beneficiary with an action contrary to his/her interests unless beneficiary agrees to the bank demands?
 - d) Has bank promised a concession orally and then backtracked?
 - e) Beneficiary informed of local statute of limitations regarding complaints?
 - f) If business interest, e.g. partnership held in trust, do officers also serve as trustees?
 - g) Are banks litigation, regulatory records open to settlors, beneficiaries? Gag order part of settlement?
 - h) Settlor/beneficiaries informed of 'business relationships' between bank and referring lawyers, bank and co-trustee? Between banks/bank counsel and local judges?

Proposed Key Administration Changes

A. Investment Related

- a) Restrict master list to those issues that can be followed intensely rather than overreliance on computer screening. Take advantage of beneficiary's specialized knowledge where possible. All else equal, preferably use issues understandable by beneficiary.
- b) Hold fixed income only if convinced rates are headed down or to maximize short term income if appropriate for beneficiary's age/situation. Invest for capital gains if only to minimize taxes.

B. Cost Related

- a) Is trust too small for economical administration? If so, trustee should offer to resign, support termination of trust or use index funds in order to reduce cost to beneficiary.
- b) If no fee rate agreement, is fee capped under statute? Some states offer cap (FL, CA), others do not (PA).

C. Control Related

- a) Limit corporate trustees right to defend to (say) a % of trust assets.
- b) Easy change from corporate trustee to corporate trustee, individual to corporate; no problem to offer bank unilateral opportunity to resign if challenged; removes monopolistic control by creating competition, encourages beneficiary to get involved.

- Also gain leverage if beneficiary serves as own co-trustee even sharing signatory authority; eliminates cost/involvement of co-trustee. Easing change of corporate trustees or from individual to corporate more cost effective than enforcing existing rules or drafting more rules.
- c) Gives beneficiary sense of control, promotes better family relations; improved beneficiary-trustee relations.
 - d) Easy removal no loss to industry; over longer term likely do better job, take business from the individual trustee, encourages more use of trusts and lower risk of lawsuits.
- D. Settlor/Beneficiary Education Related
- a) Preventative medicine is best.
 - b) What can settlors, beneficiaries expect re investments, distributions, fees, actual management practices?
 - c) Proactive disclosure of responsibilities of trustee to beneficiaries as well as the latter's rights/remedies, investing basics.
 - d) What are administrative guidelines under *Restatement of Trusts*; under local statutes? Few bright lines.
 - e) Respond promptly to questions via letter rather than phone to improve accountability.
 - f) What are remedies and how can they be pursued by beneficiary?

Conclusions

- a) Need the corporate trustee because individual trustees can't always be trusted. "Most trust scams are usually initiated by individual trustees," a probably reference to tax issues.
- b) Need for reform; you can help. Be a lobby? Grass roots ok but need federal help, even if trust/estate matters traditionally left to states.
- c) Standard practice for auditor to contact a beneficiary to confirm/deny information supplied by the trustee? If no, why not?

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