

Fiduciary Fun

Winter 2002

Information and Ideas for the Modern Beneficiary and Trust Creator

Table of Contents

Bank Trustees Come Under New Attack.....p. 1

BBC Doing A Documentary On Wills Of The Rich.....p. 1

Exchange Traded Funds and the Personal Trust.....p. 1

Problem With A Bank? Hire A Consultant!.....p. 1

Update - PA Revised Trust Code.....p. 2

Banks Argue Against Reform!.....p. 3

New Law to Benefit Beneficiaries of PA Trusts.....p. 4

Heirs® Seeks Lawyers Seeking Referrals.....p. 4

Trustees Lose An Excuse.....p. 4

Are You A Beneficiary Friendly Trust Company?.....p. 5

Heirs® in the Media.....p. 5

Trustee Compensation Issues.....p. 8

Fiduciary Fun Moving to the Heirs® Website.....p. 8

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Bank Trustees Come Under New Attack

Richard D. Greenfield, Esq. has commenced class actions recently against two major banks.

The most recent case is against *Bank of America* and its parent, *Bank of America Corporation*. The Complaint alleges that the parent company developed a scheme to convert trust funds that were individually managed and/or held within one or more common trust funds into the bank's proprietary mutual funds. Although the Complaint alleges that there was some reduction in fees at least initially, the net result of the conversion amounts to "double dipping" by the bank or its parent organization, thus costing trust beneficiaries substantial income that would otherwise flow directly to them and/or be reinvested by the bank for the client's benefit.

Mr. Greenfield's clients in the case are trust beneficiaries who live in Pennsylvania and Florida. Although the case commenced in Florida state court, it is a class action brought on behalf of all similarly situated trust beneficiaries throughout the United States who have been damaged by the acts of *Bank of America*.

As with other class actions against the *Bank of America*, Mr. Greenfield and co-counsel are representing the trust beneficiaries on a totally contingent fee basis. They are seeking information from other trust beneficiaries located in different parts of the United States whose trust accounts have been converted.

Mr. Greenfield is also litigating a substantially similar case against a major Chicago financial institution, *La Salle Bank* and its parent, the Dutch bank holding company *ABN-AMRO*. It is alleged that conversion was made into proprietary mutual funds known as the *Rembrandt Funds* controlled by *La Salle's* parent. The Complaint alleges that since their inception, the *Rembrandt Funds* have not performed well, especially as compared to other investments *La Salle* could have and should have made. As with the *Bank of America* suit, Mr. Greenfield is seeking information from other *La Salle* trust beneficiaries who have had their trust funds converted into the *Rembrandt Funds*.

If you have a complaint regarding conversion of a trust fund at *Bank of America*, *La Salle* or some other bank and would like to participate in a class action, please



Exchange Traded Funds and the Personal Trust

Notes: Due to space limitations, only Part One is included in this edition of *Fiduciary Fun*. Footnotes have also been omitted for the same reason. Part Two is available free on request by e-mail or hard copy to members or a payment of \$25.00 to non-members.

Thanks are due to Patrick Collins, a financial analyst based in Towson, MD, for his help in preparing this article.

Summary

Part One of this article contrasts index against active port-

Continued on page 6

BBC-TV Doing A Documentary On Wills Of The Rich & Famous

The program will focus on the lifestyles of people whose names are recognizable both in the U.S. and abroad. BBC has asked *Heirs®* to help locate suitable candidates. In the words of Asst. Producer Sophie Mead -

We are making a 12 part documentary series on wills of the rich & famous. Names that have come up so far have been Hank Williams (his long lost daughter Jett), Tammy Wynette, Dudley Moore, Joan Crawford, Jimi Hendrix, Andy Warhol etc. Each program will be 30 minutes long and will look at the celebrity's life - through archive footage and interviews, but also we will try to look into what that person's will said about them, how it affected their friends/family and what happened to their estate after they passed away. It's really looking at the whole issue of wills, what they say about us, how they can affect our loved ones, and how they can create enormous debate after the person has died. The program will be filmed after March and we will have finished editing it in September - so I imagine that it will be sometime in-between those dates that we'll be filming.

Anyone (relative, friend, lawyer, housekeeper, etc.) with a connection into the life of someone 'rich and famous' is eligible. BBC-TV will send their own crew over here to interview and film participants. Participants should not expect to be compensated although there is the possibility in unusual circumstances.

Please contact *Heirs®* at (610) 525-4442 if you are interested (or know of someone who might be) as soon as possible.



Problem With A Bank? Hire A Consultant!

Heirs® now has available two ex-trust department bankers who not only have law degrees but understand 'the problem' and are willing to serve as consultants. In fact, one Roger Krasnicki, Esq., St. Louis, MO has written an article entitled "A Trust Veteran's Perspective on Trust Services Today". (Go to www.heirs.net or contact *Heirs* directly for a copy.) He summarizes his experience as a trust officer below. Take heed if you are considering litigation!

Mr. Krasnicki Speaks:

After 34 years in the trust business and observing the sharp turn away from fiduciary obligations by corporate trustees, I retired and opened *Fiduciary Solutions*, a litigation support, trust consulting and expert witness service, limited to lawyers as clients. The horror stories only get worse with each passing day.

Observation #1: Large local law firms will not sue the big local bank/trustees for fear of losing the large and regular fees they get from the banks in other matters.

Continued on page 8



Update - PA Revised Trust Code

Trusts with a legal situs in PA should benefit from the new 'Revised Trust Code' to be considered for adoption by the Pennsylvania legislature in 2003. Presently under study by a Joint State Government Commission's Committee on Descendants' Estates Law, Executive Director David Hostetter will file his report in late Spring 2003. At that point a separate legislative committee chaired by Senator Stuart Greenleaf (R) will recommend whether the Code should become law with or without changes.

If present text is adopted, general criteria for trustee removal will change from "egregious circumstances" to "changed circumstances". Removal will also be allowed for inept investment performance, etc. (For complete text, contact Heirs®). Such expanded criteria for removal are an improvement over past law. But because a substantial burden of proof is still required, beneficiaries may discover that changing trustees is still cumbersome as well as costly and will not bring significant competition among banks, competition that is necessary if beneficiaries are to get needed concessions. Accordingly, Heirs® proposes that the following Act be substituted for the removal/surcharge provisions included in present text. Under the Heirs® proposal, switching trustees should prove as easy as changing brokers and facilitate surcharge actions where indicated.

We suggest you contact Mr. Hostetter as soon as possible indicating your support, copying Stuart Greenleaf and the members of his committee. For your convenience, a list of the committee members names and address appears below. For further information, go to www.state.pa.us.

If you are interested in promoting trust reform in a state other than Pennsylvania, feel free to contact us and/or your local state representative/senator and suggest that he/she support this Act. (Heirs® has backup materials which can counter virtually any objection from your local banking association!)

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AN ACT - Proposed

Amending Title 20 (Descendents, Estates and Fiduciaries) of the Pennsylvania Consolidated Statutes, providing for the removal and replacement of a corporate or individual trustee.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Title 20 of the Pennsylvania Consolidated Statutes is amended by adding a section to read:

§ 7122. Removal and replacement of corporate or individual trustee.

(a) Court approval necessary to replace.—Upon petition by the sui juris, named, non-contingent beneficiaries of a trust, the creator of which is deceased, voting so that each income beneficiary shall cast two votes, each remainder beneficiary to cast one vote, with income interests to break ties, a court of appropriate jurisdiction shall remove an incumbent trustee (individual, corporate or other entity) and replace with another trustee (individual, corporate or other entity) whether or not grounds exist for removal under Section 7121 (relating to grounds and procedure).

(b) Representation.—If there are no such beneficiaries

or if the remainder interests of any such beneficiary may be modified or eliminated by the exercise of another petitioner's power of appointment, the court of appropriate jurisdiction may appoint a guardian or trustee ad litem or shall specify representatives to represent the remainder interests. The Attorney General shall represent all charitable organizations having an interest in the trust regardless of whether they are represented by their own counsel.

(c) Reasonable costs.—

(1) The reasonable legal and accounting expenses and the costs of expert witnesses of an incumbent trustee incident to a petition for removal, surcharge, or both shall be charged to that trustee.

(2) The reasonable legal and accounting expenses and the costs of expert witnesses of the petitioners associated with petitions for removal, surcharge or both shall be borne by trust principal, except as provided in paragraph (3).

(3) If the proceeding results in a change of trustee and the trustee has failed to transfer the trust assets in kind (excepting those held in a common trust fund which may be distributed as cash) to a successor trustee within 60 days following the date on which the removal petition was acted upon by the court, then the reasonable legal expenses and costs of any expert witnesses of the petitioners shall instead be borne by the removed trustee.

(4) Regardless of the outcome of the proceeding, under no circumstances shall the trustee be entitled to charge a termination, transfer or other fee or be reimbursed by the trust or the beneficiaries or other trustees for its costs or those of any third party.

(d) Limitations on replacement and surcharge petitions.—

(1) No individual appointed as a replacement trustee shall exercise a power to make any discretionary distribution whether of principal or income to himself, make discretionary allocations in his own favor of recipients or expenses as between principal versus income, or make any discretionary distribution in satisfaction of any legal obligation imposed upon him. The preceding sentences shall not apply to a power which is limited by an ascertainable standard relating to health, education, support or maintenance. If the power is conferred on two or more trustees, it may be exercised by the trustees who are not so disqualified.

(2) No more than two removal proceedings with respect to a corporate trustee and two removal proceedings with respect to an individual trustee for a trust may take place under this section within any given five year period subsequent to the enactment of this act.

(3) An ancillary surcharge petition must be filed by the petitioner no later than 60 days following the transfer of the trust assets to the replacement trustee.

(e) Guardian ad litem.—If there are no such beneficiaries or if the remainder interests of any such beneficiaries may be modified or eliminated by the exercise of another petitioner's power of appointment, the court of common pleas shall appoint a guardian or trustee ad litem or shall specify representatives to represent the remainder interests.

(f) Substantial change in ownership or management of corporate trustee.—Any argument made against removal of a trustee which is based on a presumption that the trust creator had special confidence in the trustee may be rebutted by a showing of substantial change of ownership or management of the trustee subsequent to the trust's creation.

(g) Minimization of potential losses.—If it appears to the court of common pleas that trust property or the interests of a beneficiary may suffer loss or injury pending a decision on a petition for removal of a trustee and appellate review thereof, the court may on its own motion or on the petition of a cotrustee or beneficiary, compel the trustee whose removal is sought to surrender trust property to a cotrustee, to a court-appointed receiver or to a court-appointed temporary trustee. The court also may suspend the powers of the trustee to the extent the court deems necessary. All costs shall be borne by the incumbent trustee.

(h) Release.—In the event the trustee is removed under the provisions of this statute, and an ancillary surcharge petition has not been filed within the designated 60 day time limit, that trustee shall be released for any past administrative actions.

(i) Notification.—Within 90 days of enactment, a trustee shall notify each such beneficiary of irrevocable trusts it manages of the provisions of this section. At least once every five years, notification of the provisions of this section shall be provided to such beneficiaries of all irrevocable trusts managed for the duration of all irrevocable trusts then managed.



Banks Argue Against Reform!

It's no secret why bankers oppose giving beneficiaries practical means of changing trustees. To do so would open corporate trusteeship to the ravages of competition which over time might be expected to improve performance/accountability while (horrors!) stabilizing or perhaps even putting downward pressure on fee rates. The counters vary. For example banks argue that permitting trustee removal under less than egregious circumstances would 'violate' the intent of the settlor, a settlor it is noted that could not have anticipated the meteoric rise in bank fee rates, wholesale conversions into proprietary mutual funds, etc. Or it is argued that competition for personal trust accounts would lead beneficiaries to substitute overly 'compliant' trustees who then would permit inappropriate invasions of principal for nefarious purposes, etc. etc. This argument ignores the fact that the OCC (Office of the Comptroller of the Currency) and/or state banking commission regulate all corporate trustees, even the 'overly compliant'. Also unsaid is the fact that remainder interests contemplating a big downstream payout provide a viable check and balance to 'plundering' income beneficiaries.

The following letter dated October 9, 1997 from one David Officer who at that time was President of the *Boston Safe Deposit and Trust Company* provides a lesson in the art of legal rationalization! (It is a response to a milder version of a previous Act which was unsuccessful in gaining the support of the PA legislature.)

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October 9, 1997

J. David Officer
President
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Executive Vice President
Mellon Bank, N.A.

Standish Smith
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Dear Mr. Smith:

We have reviewed Pennsylvania Senate Bill No. 994 as well as the proposed revision to that bill which you recently submitted to us.

While the bill and the revision may be intended to eliminate certain questions and concerns raised in response to previous proposals for fiduciary replacement statutes, the very concept of this type of legislation is unacceptable from a fiduciary standpoint. The theory of these statutes is completely inconsistent with the objectives of fiduciary law of Pennsylvania and every other state, which hold that that the intention of the settlor is to be carried out. The result of such legislation would be to disregard the intentions of a settlor of a trust who clearly had the ability to empower beneficiaries to replace fiduciaries in the manner proposed by the bill, but chooses not to do so. On this basis we cannot support this proposed legislation.

Other corporate fiduciaries in the Commonwealth have similar reservations about the legislation as evidenced by the positions taken by the Pennsylvania Bankers Association in response to previous legislative proposals. It is our understanding that the PBA is likewise reviewing the current proposal and we anticipate it will soon be establishing and stating a position on behalf of its membership.

Very truly yours,



New Law To Benefit Beneficiaries of PA Trusts

By Lawrence S. Rosenwald

Perhaps beneficiaries' most frequent complaint relating to the administration of trusts is that their income seems to decline yearly. Pennsylvania's recent revisions to the *Principal and Income Act* are designed to address that issue. This legislation offers trustees two alternatives - the ability to convert to a unitrust form of administration as well as the 'power to adjust' - ie. a provision allowing trustees of Pennsylvania situs trusts to re-categorize principal as income and vice versa. To use either option, trustees must follow state guidelines.

Unitrust Administration

When guidelines for unitrust administration are met and conversion to a unitrust is complete, a trustee must distribute four (4%) percent of the (average) principal value of the trust to the income beneficiary. Given that many trusts often distribute no more than one half of that amount to an income beneficiary, the mere act of converting to a unitrust can often double yearly distributions. Moreover, the four percent of principal is based not on current value but on a three year rolling average. (Thus the effect of recent declines in the stock market are somewhat softened.) Since the general trend of equity markets over time has historically been upward trusts emphasizing growth equities should benefit both income and remainder interests under unitrust administration.

If a four percent distribution is believed to be too low or too high, affected parties can petition the court to change the percentage actually distributed. However, the presumption is that four percent is reasonable.

Power to Adjust

While the unitrust has received far more attention than the power to adjust, the latter offers even greater flexibility. The trustee's first task would be to determine the beneficiary's income needs. If traditional sources of income such as interest and dividends are inadequate, then the trustee may re-categorize items historically construed as principal to income. The statute offers guidelines as to how this is to be done. As needs change from year to year or as principal increases, a trustee may want to distribute more or less money to the income beneficiary. In the case of a unitrust, the trustee must distribute four percent unless a court orders otherwise. The power to adjust, on the other hand, doesn't bind the trustee to any fixed formula.

The problem with the power to adjust is that trustees are fearful of the implications of exercising that power. With a unitrust, the trustee has no discretion; hence the likelihood of a future successful surcharge action against a trustee is far more remote than where the power to adjust is employed. Until there are court decisions interpreting the exercise of the power to adjust, one should expect that trustees may be reluctant to exercise such a power. The smart trustee guided by the principles of the unitrust in using the power to adjust (probably) diminishes the possibility of a downstream surcharge action.

Editor's Comment

Unanswered at this writing is whether principal might be so depleted over the years to the point that the purchasing power of the remaining assets at termination was less than that of the inception assets in possible violation of the *PA Prudent Investor Statute*. The new statute also does not address the issue as to whether multiple income beneficiaries of a single trust are each entitled to 4%. (Presumably, multiple income beneficiaries on a single trust would each receive a proportionate share of the overall payment subject to any restriction within the trust instrument. Also apparently not addressed is the procedure to be followed when the remainders are minors, contingent or other than competent adults, whether a fiduciary is required to disclose the availability of unitrust/power to adjust under local statute to income/remainder beneficiaries and any available remedies if a trustee refused to implement same despite a beneficiaries' request to do so. For more information about unitrust and the power to adjust in your state, see Michael J. Zdeb's article entitled *Modern Investment Theory Comes to the Aid of Beneficiaries* in this issue and/or the *Heirs Personal Trust Handbook* (August, 2001).



Heirs® Seeks Lawyers Seeking Referrals

Heirs® is searching for attorneys interested in representing beneficiaries of estates and trusts. It is not a secret that the process of finding the 'right' lawyer can be very frustrating for beneficiaries needing representation. (It is soon discovered that the local family counselor lacks the necessary expertise while the major downtown law firm declines representation when litigation rather than mediation is proposed against a local bank.) As a result, many beneficiaries with otherwise legitimate complaints simply pass or come to Heirs® hoping for a referral.

Here is how we handle such requests. First we try to provide contact with other beneficiaries who have previously engaged local counsel so that one beneficiary can advise the other. If this strategy fails, we then suggest contacting a) a member of the *Law Professors Advisory Board*, b) someone on the *American Bar Association's Committee on Estate and Trust Litigation* or perhaps c) a lawyer of national repute in the trust/estate field.

But Heirs® would like to improve its referral process. To do so, obviously we need more information about your services. Here's what experience suggests beneficiaries want to know about you. Will counsel entertain an initial discussion at no charge to the client? Does counsel have the appropriate experience, is counsel accountable (eg. documents his/her time) and can counsel forecast the outcome and overall costs (contingency or no)?

Provide a letter with as much detail as you wish and Heirs® would be happy to pass along same (with permission and as appropriate) including your resume if desired. In your letter, please mention any core or preferred specialties (eg. breach of fiduciary duty, changing trust situs, fee disputes, tax matters, class action, real estate issues etc.), exclusions (eg. lawyer malpractice, bank removal/surcharge actions, etc.), and 'scope of practice matters' (eg. draft only, litigation, minimum account size, serve only as original counsel, removal and/or surcharge cases on contingency). Or simply call us at (610) 525-4442 if that is easier.

Thanks for your cooperation!

Trustees Lose an Excuse: Modern Investment Theory Comes to the Aid of Beneficiaries

By Michael J. Zdeb, Esq.

A long standing dispute between beneficiaries and trustees is now being addressed. Historically, trustees invested in a manner designed to balance the interests of the income beneficiaries and the remainders that would later take the principal. But, in fact, the performance of corporate trustees has left much to be desired, both in terms of investment results and trust administration. As a result, trustees frequently disappoint both the income beneficiaries with low income and remainders with little growth.

One of the justifications typically offered by corporate trustees is that the duty of trustees to balance the interests of the current income beneficiaries and remainders impartially made this result unavoidable. The argument is that the trustee's duty to the income beneficiary forced the heavy use of bonds and other fixed income investments, inherently conservative investments with little ability to grow or even respond to inflation. Some percentage of equities could be used for growth to satisfy the duty to the remainders but it 'had' to be 40% or less. As a result, many investment portfolios currently reflect a 60%/40% approach. Some beneficiaries have even successfully pressured trustees to hold an even greater percentage of bonds. Such policies are now changing because of inferior income and erosion of principal purchasing power. In other words, such policies forced trustees to adopt conservative investment strategies which limited ability for growth of income or principal.

From a legal standpoint, the word "income" as defined for trust purposes has presented an obstacle to using modern investment strategies. Simply put, "income" as traditionally defined excluded the capital gains which have been the major component of investment returns over the years and likely will continue to do so in the future. As a result, a trustee legally

Continued on page 5

Trustees Lose an Excuse: Modern Investment Theory Comes to the Aid of Beneficiaries

continued from page 4

required to produce "income" as historically defined (eg. interest and dividends) has had a difficult time basing its administrative decisions on Modern Portfolio Theory (MPT) and adopting modern financial instruments. Fortunately MPT and modern financial techniques sidestep the historic definition of income by recognizing that both traditional income and capital gains are both legitimate forms of 'return'. That's why the modern approach is called investing for "total return."

In order to remove the obstacle presented by the (old) definition of the word "income" and allow for "total return" investing, approximately 38 states have now adopted a version of the Uniform Principal and Income Act ("UPIA"). This act in one variation encourages a trustee to invest for "total return" (read emphasize equities in lieu of fixed income) and, without a court order, allows trustees to 'recast' principal items as 'income' so as to increase the payout to an income beneficiary up to a given level. Technically, this is called the "Power to Adjust." Nine states have also passed a second variation called the "unitrust" conversion option. The unitrust conversion calculates the payout to the income beneficiary as a fixed percentage of the trust where the payout itself is composed of traditional income plus principal.

A few states have adopted only the unitrust conversion approach, others the power to adjust option while nine allow both. In states that have the power to adjust option, the manner of allocation is not specified but standards are set forth in most state statutes to guide the trustee in discharging its duty of impartiality. This is the most flexible approach to resolving the issues but it requires more thought by trustees and vigilance by the beneficiaries.

In some Unitrust states, the unitrust conversion option can be adopted by the trustee acting alone or by court order and in others conversion can occur by agreement of the trustee and beneficiaries. Once conversion occurs, "income" is replaced by a fixed percentage payout, generally 4% of the trust's average value say over a three year period. Some states allow for the 4% unitrust percentage to be modified by the trustee while others require either the agreement of all beneficiaries or a court order. In short, the Unitrust approach is a "one size fits all" approach and frequently is preferred by corporate fiduciaries in order to avoid having to exercise judgment as is necessary with the Power to Adjust. In states with both the Unitrust and Power to Adjust, the option exists for trusts to adopt either one or the other and, in the latter case, allows trustees to use their best judgment regarding, for example, the most desirable payout percentage.

Despite a particular state's approach, beneficiaries in most states now have the ability to demand that trustees invest for total return and use modern investment strategies. But it is suggested that beneficiaries seek sound legal and financial advice before converting. The result should be more appreciation in principal and improved payouts to income beneficiaries. The days of disappointed beneficiaries may not be over. But one of the obstacles cited by trustees to adopting modern investment approaches is now capable of being removed!

States with Both the Unitrust and UPIA Power to Adjust

Alaska	New York
Florida	Pennsylvania
Maine	Washington
Maryland	Wisconsin
Missouri	

Unitrust Only

Delaware
Iowa
New Hampshire
South Dakota

Note: Delaware allows the trustee to adjust the rate between 3% and 5% without a court order or agreement of the beneficiaries). Illinois (Adjustment only by court order or in limited circumstances, by agreement of all beneficiaries and the trustee.

UPIA Power to Adjust Only

Alabama	Nebraska
Arizona	New Jersey
Arkansas	New Mexico
California	Ohio
Colorado	Oklahoma
Connecticut	Rhode Island
District of Columbia	South Carolina
Hawaii	Tennessee
Idaho	Vermont
Indiana	Virginia
Kansas	West Virginia
Louisiana	Wyoming
Minnesota	



Are You A Beneficiary Friendly Trust Company?

Kiplingers Retirement Report called in early October asking whether Heirs® could recommend some good trust banks to their readership. We hesitated to suggest any particular bank (or independent trustee). When *Kiplingers* pressed the issue, we responded by saying that in one sense it didn't make any difference who the (corporate) trustee was as long as the beneficiaries' interests were safeguarded. The problem is that to date no corporate trustee has been willing to offer at least the following essential firewalls:

- agree to resign gracefully at the beneficiaries' request
- agree not to invade trust corpus for any reason whatsoever without the beneficiaries' prior permission
- agree to cap the fee rate (not necessarily the absolute fee) in dollars

Any trustee willing to do the above should also have the power to resign unilaterally in favor of a replacement trustee designated by the beneficiaries if and when the relationship is no longer comfortable. (For more detail, see the *Heirs® Personal Trust Handbook*.)

There are situations where use of a corporate trustee is imperative. But in most cases, Heirs® believes that, at least for the time being, settlors or beneficiaries seeking to transfer their accounts should designate the principal (income) beneficiary (or an elected representative of the beneficiaries named in the trust instrument) as the trustee (or preferably as co-trustee with joint signatory powers over the trust corpus) or, less preferably, a family friend willing to serve without fee. In the meantime, Heirs® will keep looking for good corporate trustees in the belief that a trustee that serves a beneficiary's interests today also ultimately serves



Heirs® In The Media

Since the last tabulation of media articles, etc. as reported in the April 2000 edition of *Fiduciary Fun*, coverage has expanded just a bit! Here's a summary. Re print media, Heirs® was mentioned in twenty-six articles including eight in private newsletters/newspapers, six in magazines (including two in *Forbes*), one book, six law review or professional journals and five miscellaneous. In addition to the above, Heirs® also did three radio shows as well as appeared on a WHYY Wilmington, DE public TV show with *Bankers Trust* 'victim' Susan McCormick and friend Pat Hanley in tow. Most recently (11/13/02), the *Financial Times* carried the story of Bruce Winston's lawsuit against *Bankers Trust*. (Bruce Winston is the son of jeweler Harry Winston). The article also suggested issues that need to be addressed if estate/trust reform is to become a reality. In December 2002, the *Wall Street Journal* listed Heirs® as a resource for beneficiaries and trust creators. A coming edition of the *Robb Report* is expected to include mention of Heirs®.

Why not tell your story? The press is interested and you will be surprised how much more attentive your bank trust officer will become once you share your complaints. Or consider posting your story on your website - our our website. No charge. See www.heirs.net for details.

Exchange Traded Funds and the Personal Trust

continued from page 1

folio management, comprehensively surveys exchange traded funds (ETFs) with emphasis on cost and tax issues including previously undisclosed tax traps, explores whether an index fund is an appropriate substitute for an actively managed equity portfolio (AMEP) held in a personal trust and explains how to convince a bank trustee to switch when appropriate to do so. Part Two illustrates the computations needed to make a fair comparison of AMEP total returns against an index fund/ETF or even compare one index fund against another without the help of a computer or financial analyst.

Introduction

A recent independent third party study of bank trust department investment results indicates that in the aggregate...the managers of bank trust departments do not possess superior stock selection abilities... bank trust department portfolio managers are unable to time the market successfully by changing their portfolio betas in anticipation of differential market conditions and, thus, are unable to outperform a passive buy-and-hold investment strategy.

Trust beneficiaries and others seeking improved income, capital gains or diversification might consider a new type of index fund called an exchange traded fund. The cost/performance advantages of the index fund over the actively managed equity portfolio or conventional mutual fund are well known. For example, a 1992 Brookings Institution report states that "...equity managers seem to subtract rather than add value relative to the performance of the S&P Index...". John Bogle, respected founder of Vanguard Group, reports that the average actively managed mutual fund incurs costs totaling 5.2%, a primary reason why "...only 15% of (active) fund managers beat the S&P in a specific year. (Bracket added). To paraphrase Wiandt and McClatchy, there is overwhelming evidence...that the higher fees charged on actively managed funds are not deserved. No wonder that Vanguard's Gus Sauter can state that because of their cost advantage, "...indexed investments will be among the top performers in the long run". Less publicized is the increasing popularity of ETFs as an often less expensive and more tax sensitive investment alternative to the conventional index fund. Hence it would seem that the first step for a beneficiary seeking more cost effective investment management would be to compare a bank's performance against one or more index funds, particularly an ETF. The results might then be used to encourage a trustee/executor to switch from an AMEP or proprietary mutual fund to an ETF or even support a court petition for the recovery of damages.

Index Investing With ETFs

Cost Issues

Unlike other index/mutual funds, the ETF can be traded on the open market, currently the American Stock Exchange. For this convenience, the investor pays implicit and explicit transaction costs including brokerage commissions, 'spread' and any premium/penalty imposed by illiquid markets on 'larger trades'. Avoided are the front/backend loads often charged when conventional mutual funds are bought/sold directly through a sponsor. But it is the lower trading activity and resulting lower transaction costs that impart a significant cost advantage to ETF as well as other index funds. And indeed it is a sizeable advantage, estimated at about 2% greater annual return than typical for an AMEP or conventional mutual fund. In addition, the ETF eliminates shareholder accounting at the fund level resulting in even lower operating costs compared with other index/mutual funds. (The 'smaller' investor may wish to bypass the ETF because transaction costs incurred in multiple small lot trading will likely be significantly higher than for a conventional no load mutual fund offering shares at net asset value.)

Most mutual fund management expenses - so called 'ordinary operating expenses' - are capped by the 'total expense ratio' calculated as a percentage of assets under management. Since asset values are constantly changing, the amount charged is prorated and charged on a daily basis against a fund's net daily asset value. ETFs structured as unit investment trusts (UITs) as, for example, the *Diamonds*, *Spiders*, *Midcap SPDRs* or the *Nasdaq 100*, deduct such ordinary expenses from dividends and other income prior to distribution. If the daily operating expenses happen to exceed the prorated total expense ratio, the sponsor will make up the difference subject to later reimbursement with interest whenever there is a dividend surplus. The situation is similar with respect to ETFs regulated under the Investment Company Act of 1940 - so called 'reg 40' funds - such as the *Streetracks*, *ishares* and other 'non UIT' ETFs (except *HOLDERS*). Here dividends received on the fund's investments are not maintained in a separate account as required for UITs but commingled with assets to be reinvested in the underlying stock portfolio and/or other financial instruments prior to distribution. Hence 'reg. 40' ETF expenses are charged directly against assets or other ancillary income.

And, like all mutual funds, ETFs have expenses not captured by the total expense ratio. In the case of the *Diamonds*, these include "...taxes, brokerage commissions and any extraordinary non-recurring expenses including the cost of any litigation...(and hence)...total fees and expenses of the trust may exceed (the stated expense ratio)..." and may be charged against assets (Brackets added). For its part, the 'reg. 40' fund *Streetracks* excludes from its total expense ratio expenses such as "...brokerage, taxes, interest, fees and expenses of the independent Trustees (including any trustee's counsel fees), litigation expenses and other extraordinary expenses". In the case of the ETF dubbed '*ishares*', "...interest expense and taxes..., any future distribution fees (read fund promotional fees) or expenses and extraordinary expenses" are not considered ordinary expenses and thus are not capped by the stated expense ratio (Bracket added). Hence, the total expense ratio does not limit expenses chargeable against a mutual fund whether an ETF or conventional index fund (*HOLDERS* exempted)! In general expenses of whatever stripe which exceed the stated total expense ratio may be paid by the sponsor subject to later reimbursement with interest. Or, at the trustee's option, they may be recouped by the sale of underlying securities, thereby reducing the net asset value of the fund.

Tax Issues

ETF and other index funds are particularly tax sensitive compared to actively managed mutual funds. That's because index managers only need buy/sell in the open market when acquisitions, mergers, etc. require a 'rebalancing' of the underlying portfolio and not every time cash must be raised to meet redemption demands of an actively managed mutual fund. Hence realization of capital gains at the fund level can be expected to be significantly less. In fact with an ETF, it is the dealer (broker) rather than the fund sponsor who will cash out the individual investor's shares and who then may sell or trade same with the sponsor for the underlying basket of stocks. The latter transaction has tax consequences for the dealer but not the fund or the investor. In fact, this 'in kind' redemption process between dealer and sponsor has a tax advantage in that low basis stock can be delivered to the dealer, reducing the fund's tax liability when, for example, the fund must trade on the open market. In any event, the investor's basis is not the fund's cost of the underlying stocks but what the investor paid on the open market. Perhaps much more importantly, an investor selling shares in an index fund at a premium realizes gains on a timetable that is at the investor's discretion. On the other hand, not generally understood is the fact that a new investor buying into any mutual fund, ETF or otherwise, will inevitably incur liability for any existing unrealized gains carried at the time by the fund and will, in fact, have to pay his/her prorata share if said gains are eventually realized by the fund manager even though those gains were accrued prior to the investor's purchase of fund shares. Fortunately liability for said unrealized gains ends when an investor's shares are sold. Finally like any other mutual fund, (*HOLDERS* excepted), capital losses can be offset within the fund by the fund manager but not by the investor holding gains in a personal portfolio unless his/her fund shares are sold.

Other ETF Features

Continued on page 7

Exchange Traded Funds and the Personal Trust

continued from page 6

ETFs can be bought/sold any time during the trading day and hence liquidated more quickly than conventional index or other mutual funds which can only be traded on the basis of the daily closing price. ETF shares can also be purchased using a limit order or on margin and used to write options as well. Further ETFs avoid 'wash sale' rules and can even be sold short on a downtick, a useful strategy for delaying capital gains liability. Managers of actively managed funds also tend to keep five percent or more of assets in cash equivalents in order to avoid having to sell underlying stock quickly to meet redemptions. That's cash that an ETF manager can invest productively, thus avoiding the so called mutual fund 'cash drag'. Finally broadly based ETFs are often less risky (volatile) than an AMEP or sector fund since they are tied to an entire market. Bogle, in fact, has been quoted as favoring the broadest possible index (read *Wilshire 5000*) since "...few people can predict which sector or stocks will lead the market upward..." (Bracket added). On the other hand only HOLDERS investors can vote the underlying shares.

How Do ETFs Differ?

General

Dividends net of expenses are distributed to the investor monthly, quarterly semiannually or annually depending on the fund and will likely be insignificant for other than broad based ETFs. ETFs structured as UITs reinvest dividends awaiting distribution to the investor principally in money market funds but for the benefit of the sponsor. 'Reg 40' funds are able to utilize more sophisticated financial instruments with the additional income accruing to the investor. ETF total expense ratios also vary widely depending a) on the sponsor, b) whether the ETF is composed of domestic equities (less expensive) versus international companies (more expensive) or is c) broadly based (less expensive) rather than focused on a particular sector (more expensive). ETFs based on a representative sample of a particular index (read reg. 40 funds) rather than replicating an entire index (read UITs) enjoy lower management costs but may incur higher turnover and therefore transaction costs.

HOLDERS

A standout is the Merrill Lynch product called 'HOLDERS' which comes in multiple flavors covering broad US and international markets as well as highly specific market sectors such as biotech, internet architecture, semiconductors, etc. HOLDERS is not a conventional index fund since the investor actually owns and can vote the underlying stocks and hence is not subject to the Investment Company Act of 1940. Rather than replicating an entire sector/market, HOLDERS holds only the "...largest and most liquid companies with US traded securities involved in the (specific) industry as measured by market capitalization and trading volume...". (Bracket added). However, since specific HOLDERS funds have historically been dominated by a few major players, diversification may be less than offered by other sector funds. Dividends net of fees are delivered as received by the custodian bank directly to the investor.

Costs are also structured differently with HOLDERS. Instead of a conventional expense ratio, investors pay a fixed annual custody fee of \$8 per 100 shares which, when divided by the current market value of 100 HOLDERS shares, is analogous to a total expense ratio. Costs are not only often lower but, in fact, decrease on a percentage basis as the value of the underlying basket of stocks increases! Costs for domestic HOLDERS vary more widely than for other ETFs, currently ranging from .06% to 1.73% as compared to .09% to .53% for other ETFs. HOLDERS recently offered only one international fund at .13% while other international ETFs were available at ratios from .35% to .84%.

While the investor can purchase (sell) HOLDERS for cash on the open market, he/she can also obtain (redeem) HOLDERS shares by depositing (accepting) the required number of underlying securities with (from) the originator at a fee not to exceed \$100 per 100 HOLDERS shares. Open market transaction costs will typically be less than would be incurred if the underlying shares were purchased separately.

There are also tax differences. The new HOLDERS investor does not inherit unrealized gains at time of purchase as is the case with other mutual funds. The investor's tax basis is calculated not on the price paid per HOLDERS round lot (100 shares) but as if the investor has purchased the underlying shares directly. Note however that although the investor must calculate the basis for each underlying security based on the proportion that each represented in the HOLDERS position at time of purchase, that may be a far simpler drill than deciphering the tax consequences of a mutual fund investment! Unfortunately, custody fees are not necessarily fully deductible as are the total expense ratios associated with other ETFs since the former are treated as a miscellaneous itemized deduction. But the ability to acquire and then sell the individual securities held in a HOLDERS can be convenient if the investor has other portfolio gains to be offset, a feature not available with other mutual funds. See pages 9-13 for further information on HOLDERS and other ETFs currently available.

Is the Index Fund Always An Appropriate Substitute for an AMEP Held by a Personal Trust?

If a prima facie case can be made for the ETF (or other index fund) as a more cost effective alternative to an AMEP held in trust, the next step is convincing the trustee to consider whether substitution would be in the best interests of both beneficiary and trustee alike. The trustee may argue (with justification) that use of an ETF or other index fund as an AMEP substitute is inconsistent with the investment objectives of a particular trust. For example, an equity based index fund, ETF or otherwise, yielding (say) 2.0% or less may not be sufficient to meet a beneficiary's current income needs especially if the fund deducts expenses from dividends rather than assets prior to distribution. Or while the return of an equity index fund may average historically at least 10%, near term yields are not guaranteed and may be significantly less making it inappropriate for a trust with older rather than younger beneficiaries. Furthermore, an equity index fund, particularly a sector index fund, may in fact be more volatile (risky) than a broad based AMEP making the former only appropriate for the younger, higher risk tolerant beneficiary especially if the trust corpus is small. Some trusts may also have special tax planning objectives which can only met through an AMEP.

Are Index Results Otherwise Suitable as a Trustee Performance Benchmark?

A bank may insist that its performance only be judged by 'industry standard', i.e. against the performance of other bank trust departments. It might argue, for example, that top performing bank trust departments should serve as the benchmark, obviously a lighter burden than comparison with (say) the S&P 500. A counter argument is that in the event the bank fashioned a unique program specifically tailored to the objectives of a particular trust, then its investment results would then not necessarily be comparable to the results of trusts administered by other banks anyway! Another counter is the fact that despite advertising promoting bank's 'unique investment skills and services', it can be plausibly argued that year to year bank trust department results vary and hence no one bank can be singled out as a consistent benchmark.

Convincing a Trustee to Invest in an ETF (or Other Third Party Index Fund)

Both beneficiary and trustee may agree that an ETF is not an appropriate investment vehicle for a particular trust in which case the matter is mute. On the other hand, the beneficiary may be convinced that a change would be beneficial. In this event, the beneficiary may wish to propose a comparative study of AMEP against (one or more) ETFs. But before doing so, the following points bear consideration. Suppose indeed that a comparative study did show that an ETF promises greater total return at lower risk than a bank or individually managed AMEP. Suppose further that an existing AMEP's unrealized gains as well as switch over transaction costs are 'manageable'. Question - would the trustee, in particular a bank trustee, be likely to agree

Continued on page 8

Exchange Traded Funds and the Personal Trust

continued from page 7

to substitute a third party ETF for its own common trust fund, proprietary mutual fund or AMEP? Experience suggests that it will be reluctant to do so despite legitimate arguments that it has a fiduciary obligation to explore and even document investment alternatives with a view to making the trust assets productive and even maximize risk adjusted total return while minimizing costs. In this case, a beneficiary might argue further that broadly based index funds easily meet the diversification requirement promulgated by the *Third Restatement* (Trusts) while reflecting the performance of the US economy as a whole rather than one geographical sector. Further the *Third Restatement* (Trusts) favors index investing as a practical investment alternative for trustees and points out that "...the trustee must incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship."

But resistance will likely be strong if the bank's AMEP happens to be one of its own proprietary funds (or includes same) because the proprietary fund's imbedded costs/management fees would no longer be recoverable from the trust. Possibly the bank may offer to 'compromise' by substituting its own (often higher cost) index fund. Or the bank may agree to a third party index fund but refuse to lower its trustee fee arguing that it still carries fiducial responsibility for 'managing' the portfolio and is therefore entitled to its full fee. In this event, a beneficiary may counter by pointing out that by industry standard at least 50% - and experience suggests much closer to 100% - of a corporate trustee's fee represents compensation for handling the trust investments as opposed to its custody/accounting services and/or making the occasional discretionary fiducial decision. Furthermore, for trusts with a legal situs in a prudent investor state, the day to day investment decisions and the associated fiducial responsibility may now be delegated as long as outside investment management (read the fund sponsor) is 'qualified'. Finally, convincing a trustee will be easier if co-trustees as well as all beneficiaries named in the trust instrument whether holding an income or remainder interest are supportive.

Even if a trustee resists initially to substitution of an index fund, it should be willing to agree that it has at least a fiduciary obligation to investigate and perhaps even statistically compare total returns available from alternate investment approaches. Preferably both parties will cooperate on study guidelines. For example, the beneficiary might agree to underwrite a portion of the costs if the bank would agree to substitution - at an agreed reduction in its trustee fee - should results favor the ETF. When the bank recognizes that you are going to proceed with or without its help, it may well reconsider so that at least it can participate in setting up comparison guidelines!

Index Results as a Measure of Damages

Beneficiaries might investigate whether a basis exists for seeking reparations from a corporate trustee which, despite advertising its investment expertise, failed to change to a low cost index fund years ago. Perhaps it can even be demonstrated that the corporate trustee knew (or as an expert should have known) that lower transaction costs allow index results to consistently beat the AMEP or most actively managed mutual funds. In fact, index performance has been awarded benchmark status in court cases where damages have been assessed according to a total market return criterion. In this context, note that the success of a particular investment program can only be measured in terms of a) how well implementation is consistent with trust objectives and/or b) total investment returns. The trustee who establishes a clear, documented policy guiding the management of a particular trust can be held accountable if, barring an exculpatory clause, practice is not consistent with a bank's stated policies. On the other hand, the trustee who manages without the guidance of policy can be evaluated only on the basis of investment returns, returns that can "... only be measured by (their) relative attractiveness to the entire universe of alternative investment returns". (Bracket added). It follows that in the absence of policy a beneficiary can assert that the bank has not exercised appropriate "...care, skill and caution...(managing beneficiaries' accounts)... which, in turn, supports the use of a ...(broad equity index)... as the only measure of damages" (Brackets added). In fact, a beneficiary can attest further (to a court as necessary) that a) said corporate trustee was hired to provide investment services, advertising itself as an astute investor, b) that index investing is inexpensive, uncomplicated and promises superior returns delivered to the trust and consequently c) it is appropriate to use a broad based equity index as an appropriate benchmark against which to measure damages.



Trustee Compensation Issues

Editor's Note: A trustee defending a surcharge action limited to issues regarding trustee compensation may not be able to to recover its defense expenses from the trust.

The reasoning is based on a Pennsylvania Supreme Court case brought by Richard Green field, Esq. on behalf of Mellon beneficiary John Upp. It was ruled that the amount of compensation charged represents a business decision of a trustee and hence is not related to a trustee's responsibility as a fiduciary to manage a trust in the best interests of the beneficiaries. Patrick Collins, a class action lawyer with offices in Philadelphia, lists the duties of a trustee with regard to fees charged.

"Has the trustee explained the fees he has charged? A trustee bears the highest sort of fiduciary duty to the trust and the beneficiaries of the trust. This duty requires the trustee to take a range of actions of behalf of the trust's beneficiaries, including making disclosure to the beneficiaries of material or important facts with regard to the trust. Some courts have referred to this as the duty of candor.

Among the material facts that the trustee must disclose are the basis for and amount of fees payable to the trustee. Accordingly, any beneficiary may demand the following information of the trustee:

- the exact language of the trust instrument or other document that defines how and in what amounts the trustee receives compensation;
- the exact language of any fee schedule or schedules used at any time for determination of the trustee's compensation;
- whether the trustee uses, or has used, any other fee schedules in connection with other trusts and, if so, the alleged basis for using different fee schedules;
- the amount of all compensation (direct and indirect) paid the trustee, on an annual or quarterly basis, since the beginning of the trust through the present."



Fiduciary Fun Moving to the Heirs® Website!

Beginning with the next edition, the current Heirs® newsletter (*Fiduciary Fun*) will be available in hard copy form or electronically only to members in good standing. If you are a member and wish to continue to view the current *Fiduciary Fun* over the internet, you need only access the Heirs® website at www.heirs.net. (Call for password). As before, certain past issues can be downloaded from the website at no cost.

Problem With A Bank? Hire A Consultant!

continued from page 1

Observation #2: Most lawyers do not know what evidence is either good or allowable to prove the client's case.

Observation #3: Judges, even those who hear Probate cases on a regular basis, do not know the law regarding the management of trusts. Nor do they remember how a trust document should be interpreted. Worse yet, they don't want to know or at least be told what the law is.

Observation #4: Most lawyers don't know how to "educate" the judge before it's too late.

Observation #5: Most judges do not give proper instructions to the juries in trust cases.

Observation #6: a) Bank trustees using proprietary mutual funds are injuring their clients through poor investment performance (and their) refusal to use better performing funds managed by others. (Bracket added). b) Notwithstanding fee schedules to the contrary many corporate trustees are not properly rebating the double investment management fees charged when proprietary mutual funds are used.

Observation #7: The expert witness' fee is always too much!

Name of ETF	Market Tracked	Sponsor/ Distributor/ Vendor	Recent Total Expense Ratio	Further Information									
				A = paid from assets	D = paid from dividends as available	Ph: (800)8432639 or go to www.nasdaq-100.com	Ph: (866)STRACKS Mike Reilly at (617)8622852 or go to www.streetTRACKS.com	Dividends reinvested in money market only on a daily basis prior to distribution; structured as a unit investment trust rather than a mutual fund	Dividends, excess assets invested in money market and other financial instruments prior to distribution	Dividends net of expenses paid quarterly	Fund invests in all or substantially all of the securities comprising the underlying index.	Fund invests in a representative sample of the securities comprising the underlying index.	Convertible to underlying shares only in large blocks through originator (called 'creation units').
Street TRACKS - Dow Jones Global Titans Index Fund	50 'largest' companies worldwide	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.52% (A)		•		•	•	•		•	•	
Street TRACKS - Dow Jones Largecap Growth Index Fund	Largest US Growth Stocks	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.22% (A)		•		•	•	•		•	•	
Street TRACKS - Dow Jones Largecap Value Index Fund	Largest US Value Stocks	State Street Global Advisors (SSgA); ALPS Deistributors Brokers	.21% (A)		•		•	•	•		•	•	
Street TRACKS - Dow Jones Smallcap Growth Index Fund	Smallest US Growth Stocks	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.28% (A)		•		•	•	•		•	•	
Street TRACKS - Dow Jones Smallcap Value Index Fund	Smallest US Value Stocks	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.30% (A)		•		•	•	•		•	•	
Street TRACKS - Wilshire REIT Index Fund	US electronics/computer related companies	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.31% (A)		•		•	•	•		•	•	
Street TRACKS - Morgan Stanley Technology Index	US electronics/computer related companies	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.51% (A)		•		•	•	•		•	•	
Street TRACKS - Morgan Stanley Technology Index	US internet related companies*	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.53% (A)		•		•	•	•		•	•	
Fortune 500 Index Fund	Largest US companies	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.21% (A)		•		•	•	•		•	•	
Fortune e-50 Index Fund	50 largest US internet companies	State Street Global Advisors (SSgA); ALPS Distributors; Brokers	.22% (A)		•		•	•	•		•	•	
Nasdaq - 100 Index Tracking Stock ('QQQ')	100 diversified Nasdaq listed companies, mostly technology	ALPS Mutual Funds Services; Nasdaq Financial Products; Brokers	.20% (D)	•		•		•	•		•		

Name of ETF	Market Tracked	Sponsor/ Distributor/ Vendor	Current Custody Fee (see text)
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Broadband HOLDERS (Holding Company Depository)	US companies involved with modern data/ voice/ video	Merrill Lynch & Company; Brokers	.50%
Biotech HOLDERS	Biotech companies (about 22)	Merrill Lynch & Company; Brokers	.06%
B2B (Business to Business) Internet HOLDERS	Selected internet companies serving other internet businesses. (about 15 total)	Merrill Lynch & Company; Brokers	1.73%
Europe 2001 HOLDERS	Largest European companies trading on NYSE or AMEX (about 49 total).	Merrill Lynch & Company; Brokers	.13%
Internet HOLDERS*	Internet companies (about 17)	Merrill Lynch & Company; Brokers	.24%
Internet Architecture HOLDERS	Companies specializing in improving internet connections within/to the internet, etc. (about 21 total).	Merrill Lynch & Company; Brokers	.21%
Internet Infrastructure HOLDERS	Companies specializing in improving internet content/ functionality/ performance/ websites (about 17 total).	Merrill Lynch & Company; Brokers	1.22%
Market 2000 HOLDERS	Largest companies listed on NYSE or AMEX (about 54 total).	Merrill Lynch & Company; Brokers	.13%
Oil Service HOLDERS	Companies involved with drilling, related services for oil industry. (about 19 total)	Merrill Lynch & Company; Brokers	.14%
Pharmaceutical HOLDERS	Companies in pharmaceutical industry (about 18 total).	Merrill Lynch & Company; Brokers	.08%
Regional Bank HOLDERS	Companies in regional banking (about 18 total).	Merrill Lynch & Company; Brokers	.07%
Retail HOLDERS	Retailers (about 20 total).	Merrill Lynch & Company; Brokers	.08%
Semiconductor HOLDERS	Companies specializing in production/sales of integrated circuitry and other semiconductor products (about 20 total).	Merrill Lynch & Company; Brokers	.18%
Software HOLDERS	Software companies (about 20 total).	Merrill Lynch & Company; Brokers	.17%
Telecom HOLDERS	Telecommunications companies (about 20 total).	Merrill Lynch & Company; Brokers	.23%
Utilities HOLDERS	Utilities (about 20 total).	Merrill Lynch & Company; Brokers	.09%
Wireless HOLDERS	Companies involved in wireless communications (about 20 total).	Merrill Lynch & Company; Brokers	.15%

Footnotes

1. Toronto Stock Exchange
2. Tracks Dow Jones Financial Sector Index Fund
3. Tracks Dow Jones U.S. Financial Services Index Fund
4. According to the Wall Street Journal for July 31, 2002, internet indexes have plunged at as much as 95% since March 2000 reflecting bankruptcy of component companies and suggests that "...the days of Internet indexes may be numbered". Peter Loftus, "The Wall Street Journal", (July 31, 2002), p. C7.
5. Except Brazil, South Korea and Taiwan (all .99%)
6. (E)urope, (A)ustralia and (F)ar (E)ast

John C. Bogle October 20, 2002

Dear Mr. Smith,

Thanks for your note and your analysis of index funds/ETF's vs. "AMEFs". Of course you're right about costs, although talkies - thanks to this bear market! -- will be a much smaller drag for the foreseeable future.

Sincerely,
John C. Bogle

GET THE HEIRS® PERSONAL TRUST HANDBOOK FREE WHEN YOU JOIN

HEIRS®, Inc. was formed in February of 1991 expressly to address the grievances of trust creators and beneficiaries. Still the first and only organization of its kind in the country, it works today to improve the administration of personal trusts and estates primarily through education. HEIRS® also assists trust creators in designing a trust that will be 'beneficiary friendly' and in choosing a fiduciary that will best provide financial management for the children. Over the longer term, the organization is pushing for legislative reforms that will improve trust/estate administration.

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The Founder Of Heirs®, Inc...

As the husband of a trust beneficiary for over twenty years, Standish Smith has had first hand experience with bank administration of personal trusts. In 1991, he co-founded the Heirs® organization which today serves as a resource to both benefactors and beneficiaries searching for better trust administration. He is the author of *Onshore vs. Offshore; Where Should My Personal Trust Be Located*, which appeared in *Private Wealth* (Institutional Investor, Inc., 1999). Excerpts from *The Heirs Personal Trust Handbook* have been reprinted in *Managing Family Trusts*, (John Wiley & Sons, 1999.) A monograph entitled *Reforming the Corporate Administration of Personal Trusts - The Problem and A Plan* was recently published in the *Quinnipiac Probate Law Journal*. In 1998, he was named an observer to the Drafting Committee for the *Revised Uniform Trust Code* at the behest of the Uniform State Commissioners. Mr. Smith has addressed the Fiduciary Examiners (auspices of the Comptroller of the Currency), the New York Society of Security Analysts, the Financial Analysts of Philadelphia, the Resourceful Women organization (San Francisco, CA), the Investment Management Institute (NY), the New Jersey Bankers Association (Princeton, NJ) and the Retirement Industry Trust Association (Chicago, IL). Mr. Smith has also appeared on national / local television and radio. The activities of Heirs® have been mentioned in over 150 newspaper/magazine articles to date. He holds a B.A degree from Kenyon College and has pursued graduate studies in mathematics, statistics, and psychology.

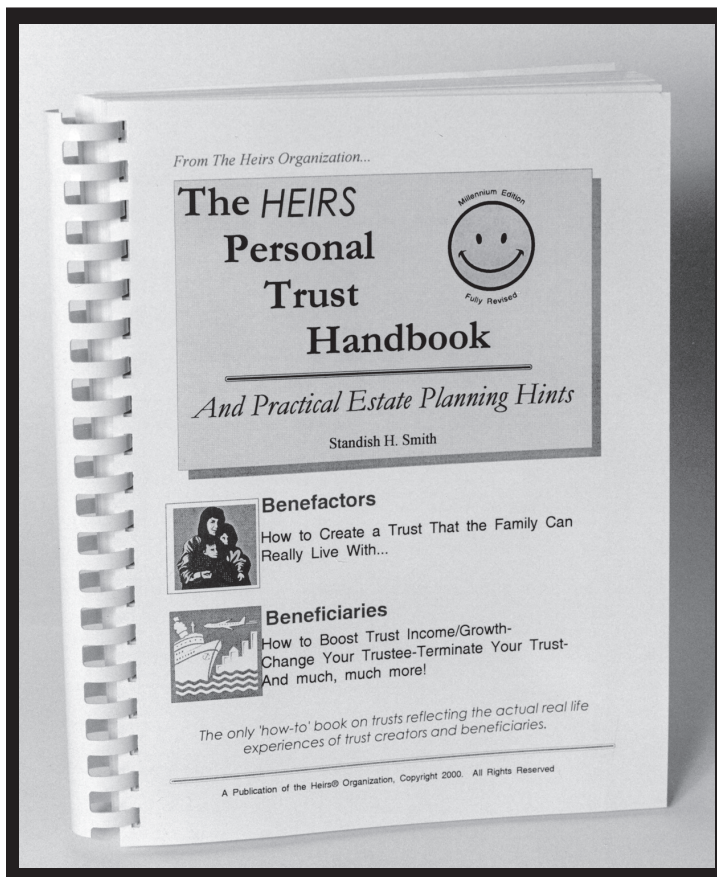


HEIRS® MEMBERSHIP APPLICATION

1. My primary complaint is _____
2. My objectives are Remove present trustee Early termination of trust Obtain compensation for past losses Better administration (specify) _____
3. Have you pursued legal remedies? Never Yes, but matters have been settled Presently in litigation Seriously contemplating
4. Does a written fee agreement exist between the trust creator and the trustee? Yes No Don't know
5. Does your trust instrument (will, fee authorization agreement) contain a clause allowing you to remove the trustee *without having to prove cause*? Yes No ; Kind of trustee Bank Individual
6. Would you like to further trust reform by participating in a class action Yes No ; Want media participation? Yes No
7. Do you want Heirs® to call you? Yes No ;
8. Personal information

Your Name _____ Address _____
 Your Phone No(s). _____ (Office); _____ (Home); _____ e-mail _____
 Corporate (e.g. Bank) Trustee Name _____ Address _____

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"I only wish my husband, Edmund, had the benefit of the *Heirs® Personal Trust Handbook* before he made up his will. He would have changed his way of thinking about the banks and lawyers...and avoided litigation with...Banker's Trust."

- *Suzanne McCormick, Concert Pianist and Beneficiary*

"This book is an invaluable addition to anyone's trust/financial library, absolutely crammed with essential information for both the trust benefactor and beneficiary. A "must read" from cover to cover."

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"Standish Smith has been fighting for the rights of trust beneficiaries for ten years. He brings to his subject a unique combination of passion and expertise. In this book he selflessly shares the most potent tools in his arsenal: his knowledge and his empathy. It's an indispensable personal guide for anyone who must suffer the travails of a trust situation."

- *Dan Rottenberg, Editor, Financial Journalist and Author; Most recent book "The Inheritors Handbook" (Bloomberg Press)*

"I am well aware of the absolute powerlessness of people who have the misfortune of being beneficiaries of trusts managed by incompetent or dishonest trustees. I commend...Standish Smith for his persistence in educating beneficiaries to practical alternatives...."

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"The *Handbook* provides a different perspective from that usually available to beneficiaries..."

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- ◆ whether your trust has grown with inflation and/or the S&P index
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- ◆ model letters requesting concessions such as a fee reduction, etc.
- ◆ techniques for changing a trustee or terminating a trust
- ◆ listings of trustee removal statutes as well as statutes limiting suits against trustees
- ◆ specimen agreement insuring that a replacement trustee will act in the beneficiaries' best interests
- ◆ how to get more help - names/addresses of state bar associations/banking commissions, professional trust/estate litigators, 'beneficiary friendly' law professors, etc.

Benefactors will embrace the *Heirs® Personal Trust Handbook* because it solves myriad practical issues involved with creating a trust -

- ◆ when a personal trust is and is not worthwhile
- ◆ how trusts can differ in reducing taxes, controlling the use of your legacy and creditor protection
- ◆ custom designing a beneficiary friendly trust
- ◆ the pros/cons of bank vs. individual trustees
- ◆ avoiding problems by 'omitting' the trustee
- ◆ specimen settlor - trustee agreement insuring that the trustees act properly
- ◆ which states are more 'trust/estate friendly'
- ◆ directory of independent corporate (non-bank) trustees

Comptroller of the Currency

"All trust beneficiaries owe Standish Smith a great debt of gratitude for his attempts to define, protect, and expand trust beneficiaries' rights. His book belongs in every public library in the U.S. and abroad."

- *Robert Whitman, Professor, University of Connecticut School of Law*

"All too frequently the legitimate inquiries of trust beneficiaries are met by the obfuscations of trust department personnel. The millenium edition of *The Heirs® Personal Trust Handbook* cuts through all of that. It is a 'must read' for anyone who contemplates naming an institution as trustee. Why? Because it goes beyond the propaganda, puffery, and self-serving correspondence that is so much a part of the culture of today's trust bureaucracies. The appendices are a treasure trove of useful data for lawyers and non-lawyers alike."

- *Charles E. Rounds Jr., Professor, Suffolk University Law School and author of "Loring - A Trustee's Handbook", a Standard Reference Text*

"Your in-depth work (regarding) trustee/fiduciary/beneficiary relationship(s)

HEIRS[®], Inc.
PO Box 292
Villanova, PA 19085

Address Correction Requested

about communications

- **Change of Address**
If you have moved or anticipate doing so, please let us know now. At least give us an alternative phone # (friend, etc) who knows where you are going.
- **Want Future Mailings?**
If not, please drop us a note so that we can keep our losses down. In 2001, Heirs[®] Inc. incurred a deficit of over \$15,000 and has sustained equivalent losses since 1991.
- **We Need Your E-mail Address!**
Until the future of Heirs[®] is assured by a kind benefactor, Heirs[®] must watch its constantly increasing costs in order to minimize its annual deficit. For example, the 10/3/02 postcard sent recently to over 2,400 beneficiaries, prospective trust creators, lawyers and others cost over \$800 for printing and postage alone. By E-mail, the cost would have been negligible! So PLEASE - send us your E-mail address or that of a friend who does have a computer. If we have your E-mail address on file, you will be first in line when an opportunity arises for a story in the media!

notes

- #1 - **Current Heirs[®] Publicity** - For tips on avoiding problems with a trustee, check out both the *Wall Street Journal* for December 17th, 2002, page D-1 and the *Financial Times* for November 13th, page 26.
- #2 - **Class Action Anyone?** Occasionally we hear complaints that divide beneficiary and bank, complaints that others often share. For example, consider the adverse tax, investment performance and cost consequences when a bank converts a bond/equity common trust fund to a proprietary mutual fund. Others involve a trustee's undisclosed interest in a company whose securities are held in a personal trust (Enron?), a trustee failing to disclose acting as principal in the sale of bonds into a trust account, offering up to a 20% discount on management fees to some beneficiaries but not others, failure to swap bonds at year's end to cover federal and state income taxes, and so forth. Even if the financial impact on a particular account may not be particularly significant, such issues cry for reform - and may be addressed via the class action without cost to the beneficiary. Heirs[®] has access to a former trust officer with a major midwest bank and lawyers with class action experience who are available to work with beneficiaries interested in participating.
- #3 - **Other Reference Material** - Readers interested in reading further about estate/trust issues may go to the American College of Trusts & Estate Counsel (ACTEC) website at www.actec.org. Another suggestion is American Bar Association's flagship journal, *Real Property, Probate and Trust*, accessible (for an annual membership fee of \$115) at www.law.sc.edu/rpjh.htm. Call (800) 285-2221 for details.
- #4 - **New Book** - Bob Whitman's new and highly readable book called *Prepare To Estate Plan in 2003* is now available at www.graduategroup.com and presently also at the Amazon and Barnes & Noble websites.

HEIRS[®], INC.

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