REFORMING THE CORPORATE ADMINISTRATION OF PERSONAL TRUSTS – THE PROBLEM AND A PLAN

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BACKGROUND

The National Conference of Commissioners on Uniform State Laws is presently at work drafting a revised Uniform Trust Act which if adopted by the various state legislatures would provide model statutory law for personal trust administration. Originally conceived in 1931, this omnibus act will be presented to the state commissioners for their approval probably in the summer of 2000.

The banking industry has always been involved in the evolution of the Uniform Trust Act—being first suggested "…by the Trust Division of the American Bankers Association (ABA) in order to, in part, "…relax a few equity rules regarding trust administration…in order to facilitate convenience in the (corporate) administration of trusts". [2]In fact, the ABA today continues to advise the Commission as to whether its state banking affiliates (lobbies) will provide the support that can be so critical for its enactment.

While the drafting committee for the revised Act recognizes that "…a uniform act cannot be adopted in a significant number of states unless it represents fair compromises between competing interests…(It also recognizes that)…there are some legitimate needs of beneficiaries that need to, and will be, addressed."[3] To this end, it was at the suggestion of Professor Robert Whitman of the University of Connecticut School of Law and with the forbearance of committee chairman Chief Justice Maurice A. Hartnett III that the Heirs® organization was asked to present (for the first time) the consumer's point of view at the October 1998 meeting of the National Conference of Commissioners in Rapid City, SD. At that meeting, the author pointed out that the legal playing field between a corporate trustee and the beneficiaries of a personal trust can be unbalanced in favor of the former, a situation which is sometimes advantaged by banks to a point that may at times compromise a corporate trustee's duty of loyalty. Indeed, the author emphasized that while a relative, friend, etc. serving as a trustee may require and indeed deserve certain protections if he/she is to be encouraged to serve altruistically, a corporate trustee doesn't need such encouragement when providing administrative services for profit. Hence it was argued that new, tougher rules need to be put in place for the latter that would both a) offset federal and state law that serves the banking interests but not necessarily those of the consumer and b) prevent the industry from continuing to use its deep pockets and financial sophistication in a manner sometimes detrimental to beneficiaries.

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[1] Standish Smith has dealt with the practical problems posed by irrevocable personal trusts for a number of years. While not an attorney, he has combined a background in human factors research with a personal commitment to improve the bank administration of a family trust by co-founding (in 1991) a beneficiary advocacy group known as Heirs®. Today Heirs® serves as a resource to beneficiaries as well as settlors seeking improved trust administration. Two of its principal publications include *A Survey of Trustors and Trust Beneficiaries* (1992) and the *Heirs® Personal Trust Handbook* (1999).

[2] Uniform Trusts Act, National Conference of Commissioners on Uniform State Laws, as approved at its conference in Kansas City, MO, September 20-25, 1937.

[3] Personal communication (letter) from Chief Justice Maurice A. Harnett III, Chair of the Drafting Committee for the Revised Uniform Trust Act, to Standish H. Smith, dated October 26, 1998.

Acknowledging that certain reforms would be inordinately difficult to get enacted by state legislatures where the banking interests are deeply entrenched, it was suggested that the state commissioners focus their efforts in those sparsely populated states where the bankers are presumably less entrenched as well as in states which are currently proactively seeking new trust business. Because settlors can site their revocable trusts in any state they choose, settlors could then promote interstate competition by favoring those states which are 'beneficiary/settlor friendly.' It was also suggested that beneficiaries could also promote competition if the Act included a provision allowing them to change the legal situs of their trusts.

The reader should know that the author's interest in personal trust stems from the fact that his spouse has had a trust managed by a local bank for over twenty years. She has always been of a mind that the bank was exclusively promoting her interests. But it was clear to the author at the onset that this was not necessarily so—that the bank had its own agenda. So, in protest, a group of like-minded beneficiaries on Philadelphia's Main Line decided to form a group that would eventually come to be known as the Heirs® organization. Fortunately, following that initial meeting, a newspaper article resulted in over 160 inquires—mostly from beneficiaries with accounts at said bank. The author discovered that his complaints—lack of communication, rising fee rates, investment issues and always it seemed an arrogant, independent, patronizing attitude on the part of the bank's trust officers were shared by others. So he was not surprised when a bit of research turned up a 1990 article by former Bank of New York CEO J. Carter Bacot entitled *In Trust We Profit*[4] in which it was acknowledged that beneficiaries often complain about the administration of their personal trusts including, in particular, the high rate of turnover of trust officers and their lack of experience and expertise.

AN HISTORICAL PERSPECTIVE

In the beginning (circa 1940 and earlier) when it was time to preserve the family assets for the children, the wealthy often chose to place those assets in an irrevocable trust to be administered by a friend or perhaps by the trust department of a local commercial bank. And it was probably a good idea. If the child wasn't quite mature enough to handle his forthcoming inheritance – or even if he was – at least he would be guaranteed an income for life and later his issue would enjoy the principal free of any additional death taxes. And the device kept the assets within blood lines where, after all, they rightfully belonged—away from the clutches of the in-laws in the event of a divorce or premature death! And so it was that commercial banks, mostly as an accommodation to their wealthier customers, were encouraged to set up trust departments, entities which were run independently of commercial loan operations. If these departments were not expected to earn a profit, they at least fostered the image of the bank as a caring institution and assisted in maintaining the lines of communication between old and potentially valuable future customers. Too, trust departments could and did serve as training grounds for new hires as well as convenient resting places for those no longer productive enough to earn their keep on the commercial side. And, if the pay scale failed to attract the best investment minds, at least the trust department could always be depended upon to serve a useful social function by providing a degree of investment expertise as well as management continuity. During this earlier, albeit simpler, era when old money exceeded new, loyalty between individuals was an important social value, and 'society' could be trusted to pass the word if the bank misstepped, the bank trustee probably delivered a level of care that truly could be characterized as one of 'in loco parentis.'

[4] *In Trust We Profit*, Bacot, J. Carter, *United States Banker*, March 1990, p. 54.

Whether the modern trust department still deserves the image of benevolent ineptness borne from these earlier days is an open question. What is true is that in today's increasingly competitive, autonomous, and litigious society, a bank trustee is likely to be an individual (or more likely a series of individuals) who has rarely met the beneficiary and whose rules of conduct are explicitly detailed in a bank policy manual rather than guided by a strict sense of personal ethics. He can act with more impunity than his predecessor because the typical trust department has numerically more clients than before (the corpus for each representing a diminished percentage of total assets handled) and his clients, for the most part, do not know one another. And while these changes do not enhance the integrity of the beneficiary-trustee relationship, another development threatens even greater strain—the transformation of the trust department into a major profit center and with it an increasing demand that the corporate trustee show loyalty to client and stockholder alike even though their interests are fundamentally in conflict. In fact, even by the early seventies, pressure for greater profitability along with increased tensions between beneficiaries and their bank trustees was becoming evident. Consider the comments of one Donald Etra who directed a Ralph Nader study of the First National City Bank in 1973.

> *The conflicts of interest between bank commercial and trust departments regularly favor the enrichment of the former. Trust beneficiaries and pension plan participants are deprived of the information and rights (needed) to participate in the management and investment of their money. Trust and estate lawyers work closely with the bank to perpetuate this oligarchic condition. He continues... "the new 'profit-center' banks are seriously disturbing many older or retired bank executives who see the trust function of banks being ramshackled by the supermoney and superconglomerate dealings of the new bank managers. Some of them have discussed these matters with the study group, but still more are needed to speak and act to further those ideas that they believe are being violated wholesale in the pell-mell rush for profits...(Further) while almost complete yet unwarranted secrecy surrounds the trust activities of banks, the public has been, of late, becoming increasingly aware of the conflicts that arise when a commercial bank also provides trust services. Some of the conflicts are more subtle: a trust department can deliberately keep a portion of a trust fund uninvested and leave the uninvested cash in demand deposits with the commercial bank. The presence and potential for such conflicts demand that the public ask whether trust departments have any place as part of a commercial bank."* [5]

Etra goes on to describe beneficiaries' tensions at the time as aptly summarized by the response of one respondent to a later questionnaire addressed to 140 beneficiaries with accounts managed by National City Bank.

> *One refused to answer explaining that, "I really did not know what to look for or how to judge what the bank (is) doing. Besides I do not want to get anybody in trouble. That trust fund is all I've got now—I have to rely on the bank for my money, you know."*[5]

[5] *Citibank*, Leinsdorf, David and Etra, Donald, Viking Compass, Grossman Publishers, N.Y. 1973.

Finally, as economic factors continue to force more banks into merger and reorganization, the pressure to contain costs will continue to focus on these operations which traditionally have contributed the least to the bank's overall bottom line—viz. the trust department. [6] And as the trustee is pressured to serve more clients, handle more responsibility for each of those clients, and work to secure new business, the standard of care that can be provided for each client must fall. In sum, the modern corporate trustee is no longer in any sense a surrogate parent but a businessman working in an expanding national industry in which banking institutions (including those with national and state charters) as well as other financial institutions serviced over 849,000 personal trusts containing over 805 billion in discretionary trust assets as of the end of 1997.

HEIRS® SURVEYS BENEFICIARIES' OPINIONS

Consider a service which the consumer must accept and pay for even if unsatisfactory and for which the fee is typically set by the vendor rather than by market forces. Consider the fact that the consumer can not buy the same service elsewhere; hence the vendor enjoys a monopoly. Should the consumer attempt to remove the vendor, his property may be partially confiscated. The 'service' we describe is not a mob protection racket but often an irrevocable trust administered on behalf of a beneficiary by a bank.

In trusts where the right to change the corporate fiduciary without having to prove cause is absent (which is typically the case for older trusts), the corporate trustee is held in check principally by a body of (state and federal) law which is often non-specific and, for practical purposes, inaccessible unless the beneficiary is willing to risk his/her trust assets in the hope of relief. And so the question must be raised as to whether corporate trustees by and large have managed to balance the interests of both their shareholders and trust beneficiaries equitably in spite of the potential for abuse. The Heirs® organization, a group composed mainly of beneficiaries of (bank managed) irrevocable trusts, concluded the question was legitimate and could be addressed at least in part by a survey of its membership. Thus, in the early summer of 1991, Heirs® began mailing members a 52-question survey designed to evaluate the management of their trusts and to reveal areas in which trust administration could be improved. The survey asked participants to provide certain basic information such as the initiation date of their trust, number and identity of the trustees, referring party, asset value, etc. The participants were also asked to voice their concerns with the administration of their trusts -- especially with regard to portfolio performance, fees and service. Questions probed the beneficiaries' understanding of the trust instrument and attitude towards his/her corporate trustee -- in particular, whether he/she was confident that the trust would continue to provide financial support for life.

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[6] To quote from the 1990 edition of the *Trust Department Manual* published by Sheshunoff Information Services, Inc., "the trust area represents one of the last untapped areas of potential profitability and trust departments must become assertive marketers and providers of services." This remark was published at the same time that Mary Miller, then a VP for BEI Golembe (now defunct), observed that, "…25 percent of the financial institutions are unprofitable" …(and that) "…fee income from a trust organization can…produce a substantial contribution to the parent/host's bottom line." (From *New Study Seeks Successful Strategies for the '90's*, Miller, Mary M., Trusts and Estates, January, 1990.) Indeed, in a contemporaneous United States Banker article entitled *In Trust We Profit*, Bacot testified that, "…increases in the revenue flow from fee based services…(is possible)…because of relative inelastic pricing. Explaining, he suggested that there is "…a reluctance of the typical customer to shift to another service provider without very good cause…and that most clients have reasonable investment objectives."

Over 500 survey forms were distributed out of which 73 surveys were returned. As might be expected, not every respondent answered every question so that the data pool varied from question to question. Typically, the individual who filled out the survey was a beneficiary of a trust or, in a very few cases, a prospective trustor (settlor) who might also be a beneficiary (of his own trust). A few key results are presented below.[7]

As could be expected, growth in absolute dollars correlated both with the percentage of assets held in equities vs. fixed income and trust duration. Nevertheless, on the whole, respondents' trusts did very poorly. For example, 28 accounts with an equity percentage of 41-80% and a mean duration of about 25 years showed a mean annual percentage change in portfolio value of about +2.7% vs. an average big cap gain of about 7.5% over the same time period. Results were also dismal in terms of income performance with the average trust gaining about .9% annually compared to an average inflation rate of 3.15% as measured by the CPI. While these results are hardly representative since our sampling tapped mainly seriously dissatisfied beneficiaries, arguably banks being professional managers might have delivered more consistent results. What is perhaps more important is the fact that only 30% of respondents indicated that they had been counseled regarding the pitfalls of investing for near-term high income. The survey further demonstrated an unwillingness of banks to offer beneficiaries basic investing fundamentals as well as information on their rights, the responsibilities of a fiduciary and explanations underlying their administrative actions. Indeed, experience would later confirm that banks, perhaps due to inexperienced personnel or deliberate evasiveness, do not communicate responsively, much less volunteer information despite the fact that beneficiaries need and are entitled to material information concerning the administration of their trusts.

Another major complaint uncovered by the survey was rising fee rates. The aforementioned bank, for example, has raised its rates 350% over the last twenty years with no discernable change in either investment acumen or service.[8] And this bank is not alone. Industry sources report that bank management fees rise on the average every 2-3 years.[9] In this connection, it is worth mentioning that as banks continue to shift assets from common trust funds into proprietary mutual funds typically on an involuntary basis, costs to beneficiaries are increasing from 50 to 100 basis points without comparable benefits.[10] And banks also have demonstrated a habit of adding charges for sweeping of daily balances, termination, legal services, etc., costs that are typically compulsory and not anticipated by the settlor but which do indeed swell margins even as bank's market share continues to diminish.

THE CORPORATE VS. THE INDIVIDUAL TRUSTEE

How can corporate management be made more accountable and competitive with others who would manage money for profit? The main thing we need to recognize is there is a fundamental if obvious distinction between an individual and corporate trustee. While individual trustees have been known to pinch trust assets, they generally serve altruistically and at least were personally known to the settlor. But a corporate trustee is not only responsible to its stockholders and therefore must maximize profits but may not even have been known to the

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[7] From *A Survey of Trustors and Trust Beneficiaries*, The Heirs® organization, (1992).

[8] Testimony during a class action targeting said bank over the issue of sweep fees revealed that it earned an operating margin of 45% on its personal trust operations v. 5% on the commercial side during 1992.

[9] *Trust Department Manual,* Sheshunoff Information Services, Inc., Mennis, Edmund A., 1990 p.iii.

[10] *Trust Regulatory News*, March 1997, p.1.

settlor due to merger, etc., And it is uniquely the corporate trustee that ensures a durable stream of ever increasing profits through standard fee schedules that are not standard, proprietary mutual funds, reductions in service, and administrative measures designed to minimize the risk of removal and/or surcharge. Because banks have this unavoidable conflict of interest, the author believes that the rules need to be different and tougher for the corporate trustee. For example, absent fraud, etc., it makes sense to allow an individual trustee to defend using trust corpus because otherwise it might be difficult to get individuals to serve. But should a corporate trustee be able to recover the costs of its own legal defense or a court accounting in the name of defending the trust since it is in the business to make money and therefore could be expected to bear some risk? And again, why should a corporate trustee be allowed to name its own fee where an explicit fee agreement authorized by the settlor is in place or improved service/better investment performance cannot be demonstrated? Why should some—but not all—beneficiaries have the advantage of a discount to the bank's standard schedule? Why, indeed, should beneficiaries be required to pay constantly increasing rates when, as is typically true with older trusts, the beneficiary lacks a trustee removal clause and hence is precluded from seeking more cost effective administration? (After all if the bank does its job well, principal will rise and with it principal based fees). On the other hand, beneficiaries whose trustees are individuals generally don't appear to have such problems even if the individual charges for his services. In fact, beneficiaries with individual trustees rarely contact Heirs® for help despite the fact that the number of individually managed trusts is certainly an order of magnitude greater than corporately managed trusts.[11]

COUNTERBALANCING THE CORPORATE TRUSTEE'S CONFLICT OF INTEREST

In theory, a trustee of a personal trust represents the interests of the settlor and, derivatively, those of the beneficiaries. In theory, the trustee stands in the shoes of the settlor. In practice, however, it is clear that the broad powers granted to trustees can be abused. Even the beneficiary who serves as his/her own trustee may not always administer in the manner intended by the settlor in which case there is even a conflict of interest between beneficiary and settlor! But the point must be clear. A fox can be trusted to guard the hen house only if someone watches the fox! Many factors contribute to an unbalanced playing field between the parties. For example, despite whatever constraints are imposed by the triple threats of audit, negative publicity (whether by word of mouth or via the media) or even the occasional sidewalk demonstration (a recent phenomenon), it is uniquely the corporate trustee that can marshal the economic and intellectual resources to defend its administrative practices. And while trust law is commendable for its breadth, flexibility and attention to the wishes of settlors, often it is too complicated and lacking of 'bright lines' for rigorous administration in practical situations, much less understandable by beneficiaries. (Witness the byzantine criteria imposed on trust investments under the prudent investor rule!) Hence trust administration is really more art than science, depending to an inordinate degree on the sophistication, good judgment and faith of the trustee. Then too, the partiality of the law and courts in favor of the trustee, especially where management fees and legal costs are concerned, and the degree of discretion afforded trustees by trust instruments as well as the extraordinary difficulties and costs of representation imposed on

[11] According to a bank trade journal, "…as of 1990, the overwhelming majority of 'bank' customers opt for non-banks when it comes to trust management." From *That Personal Touch In Personal Trust*, Violano, Michael, The Automated Banker, June 1990, p. 33.

beneficiaries who elect to challenge a trustee creates an arena where the high ground is held by the corporate trustee. Indeed, experience and logic suggest that personal trusts might work better for settlors and beneficiaries if the leverage of a corporate trustee was restrained by other consideration(s) or agency(ies) such as mandatory disclosure of the rights of the consumer and the responsibilities of corporate trustees, provision for an individual co-trustee/trust protector, a power of the beneficiaries to choose their own corporate trustee, provision within the instrument for beneficiary approval over certain administrative actions, and/or co-custody (sharing signatory control of the trust assets with the beneficiaries). Unfortunately, present day corporate administration of personal trusts lacks such and balances.

HOW ARE BENEFICIARIES IMPACTED BY CURRENT COPORATE ADMINISTRATIVE PRACTICES?

Beneficiaries of irrevocable personal trusts often fear negotiating their interests with a corporate trustee and with reason. Given the fact that a corporate trustee always has exclusive 'custody' of the trust assets, (read sole signatory authority), it is well positioned to dictate administrative and dispositive policies in the first instance generally without the consent of the beneficiaries or even an individual co-trustee. Of course, sophisticated beneficiaries are aware that disputes may be referred to the court for resolution but often recognize the practical difficulties in doing so. Those less sophisticated are inclined to trust the bank to act impartially, feeling it is more important to maintain a "friendly" relationship lest it demand a court accounting with attendant costs deductible from the trust corpus, wield its discretionary powers to withhold a needed principal/income distribution, shift income from one beneficiary to another, demand a "termination fee" when the account is merely being transferred plus even an 'initiation' fee at termination, move trust corpus from productive investments into money market funds pending final distribution or, as is believed typical practice, delay final distribution in order to continue drawing its management fees/coerce a release! Indeed, a bank can put the beneficiary in such a position that the latter's only remedy is to apply to the court for relief in which case, unfortunately, the beneficiary will bear his own costs of representation personally while the trustees' legal costs—perhaps by expensive third party counsel—may well be borne by the trust and charged prior to court adjudication. And even if a beneficiary can locate competent, affordable and independent representation, a difficult task especially in a major metropolitan area, the beneficiary may be forced to parry motion after motion to a point where continuing a legal challenge is no longer practical. Everyday people with jobs and family responsibilities for whom knowledge of matters fiducial is merely rudimentary simply aren't prepared to face a deep pocketed bank intent on maintaining its fee base. In other words, banks have the option of stonewalling a beneficiary's demands where only it understands that the court is more apt to defer to the bank than to the beneficiary. To quote Jeffery L. Crown writing in *The Emotionally Disabled Trustee* published as part of the proceedings of the 1979 Miami Institute on Estate Planning, "courts sometimes seem more eager to protect the trustee than the beneficiaries…the judicial removal process is still grounded in the fault concept". Mr. Crown goes on to point out that we "…must devise a fair, workable method to replace the trustee, which will neither affect his reputation nor give the beneficiaries so much power that his hands are tied..." Thus while beneficiaries can petition the court to review a trustee's fees or other administrative policies, beneficiaries rarely choose this "remedy." In short, the corporate trustee can and sometimes does exploit its monopolistic position in order to restrain its clients. Consequently, beneficiaries

frustrated by incompetent investment management, rising fee rates, and an ever changing stream of often than less expert account administrators, typically choose to endure rather than confront.

It is difficult to assess the proportion of good corporate actors to bad. Because it is the latter that get the ink, they may appear to outnumber the former even though the opposite might be just as true. But whatever the case, it is clear that examples of inept, self serving management abound, suggesting that corporate administration of personal trusts is not all that it might be. Certainly some banks will resign gracefully on request but only if the account is small-say a few hundred thousand and the beneficiaries will agree to a 'termination' fee of up to 2% of principal plus a release. Experience also suggests that the independent (non-bank) corporate trustees will resign more often than will banks when asked to do so. But do banks generally fail to embrace an open door policy because to do otherwise might result in an exodus of clients? Could the lack of an open door policy be considered a self indictment of a bank's own performance as a trust administrator? In any event, when the stakes are sufficiently high, banks can and will defend their interests zealously (read overlitigate) in seeming disregard for the interests of the settlor and his beneficiaries. For example, a major Pittsburgh bank administering a charitable trust worth in excess of 400M was asked to step aside in favor of another Pittsburgh bank that had agreed to charge one-half the rate of the other bank, thus allowing distributions to local charities to be substantially increased. Despite the expenditure of legal fees in high six figures, an appeal to the Attorney General of Pennsylvania and the appearance of the trust's director at senate (PA) hearings on a Heirs® sponsored bill providing for 'practical portability'," the incumbent trustee to this day still refuses to resign! Such conduct, so clearly antithetical to a fiduciaries' duty to uphold trust objectives, simply reflects the corporate trustee's appetite to expand beyond the prerogatives of legal ownership by sharing the beneficial interest as well! Perhaps that's one reason that informed settlors are increasingly shying away from using corporate trustees as administrators, a trend which may not be reversed until beneficiary/settlors rights are enhanced by remedial legislation. And perhaps that's why settlors with mega-millions to pass on traditionally bypass bank administration all together in favor of a family office!

WHY EASIER MEANS OF REPLACING AN UNSATISFACTORY CORPORATE TRUSTEE IS JUSTIFIED

Predictably, banks will argue that the settlor could have included a removal clause if he so chose and that its absence was not a 'mistake of expression' in drafting but demonstrated an deliberate intention to lock in the settlor's beneficiary(ies). And courts presumably have supported this viewpoint even though the settlor could have expressed his intentions affirmatively (rather that by default) simply by including a specific provision prohibiting the bank's removal. The appointment of a particular trustee by a settlor together with the absence of a removal clause within the trust instrument may well have been informed decisions on the part of the settlor. However, the settlor may just as well not have been properly advised by counsel which was more interested in developing a business relationship with the local bank. Or perhaps neither counsel or settlor considered the possibility of changing circumstances which might later significantly impact the trust's administration. And there are other explanations for the omission of a removal clause in specific situations. For example, IRS Revenue Ruling 95-58 (published on August 15, 1998) and subsequent letter rulings have markedly reduced the threat of adverse tax consequences if the beneficiaries enjoy an unqualified removal power in the instrument. Nor could a settlor who years ago opted for administration with the local bank simply because of an

existing personal relationship with that institution anticipate the wave of merger activity which would later threaten to destroy that relationship, forcing the beneficiaries into unknown administrative territory. Indeed, it is difficult today to imagine an informed settlor offering control of his/her legacy to a corporate trustee-despite a perceived preference for professional, secure, durable administration-without first demanding a removal clause plus a written agreement concerning fees/costs and other concessions. Hence the absence of a removal clause or other means of obtaining relief may not necessarily reflect the settlor's best intentions or be in the best interests of the beneficiaries.

To argue-as banks tend to do-that the absence of a removal clause represents a deliberate act reflecting a profound faith in the administrative services of a particular corporate trustee is nonsensical even in a past era when trust administration was a loss leader and word-of-mouth could be depended upon to curb corporate excess. Certainly special circumstances can exist where the availability of a removal clause might be disadvantageous by allowing a beneficiary - say with self destructive tendencies - to threaten removal unless the trustee complied with his/her demands. But to deny all beneficiaries the benefits of competitive administration because a particular settlor failed to insist in the instrument that the trustee could not be removed under other than the usual egregious circumstances is arguably not in the public interest. In any event, special needs' trusts are relatively uncommon. But would a corporate trustee be subjected to frivolous demands by beneficiaries seeking to use a removal petition to force inappropriate concessions? Would beneficiaries suddenly start shopping their accounts around town chasing the bank with the hottest investment numbers? Maybe but not likely. Experience again suggests that complaining beneficiaries almost always have legitimate reasons for doing so. Further, in the event of a demand to capitulate or lose the account, it is difficult to imagine an informed substitute corporate trustee willing to offer a 'needed concession' since the risk factor in granting such an inappropriate concession would be the same as for the incumbent trustee. Too, corporate fiduciaries are subject to audit and other regulatory provisions that at the least are designed to insure that beneficiaries' interests are not unduly compromised. And regardless of the quality of the issues involved, a troublemaker beneficiary (such as the author) will soon discover how difficult it can be to line up a corporate trustee because incumbent and replacement trustee will almost certainly communicate before the account is ever switched. In any event, easier access to alternative management should promote good behavior by line trust administrators who well appreciate the risk of losing the account if performance is substandard. And certainly in situations where the stakes involved are significantly high, an incumbent will be discouraged from overlitigating a removal action by the proposed revision! [12]

But banks have other arguments to support their opposition to removal clauses. They often say, for example, that it was the settlor who expressed a 'special confidence' in designating the bank as trustee. In fact, however, it is likely that the settlor elected to use a specific bank simply because no suitable individual was available to serve and that, even if that were not the case, any such relationship would have long been destroyed upon merger with another institution. As law professor Mary Louise Fellows noted during a recent panel discussion on the portability issue, "…it's not nearly so clear to me that (the) settlor has a specific interest about a

[12] It has been argued that competitive bidding would "…tempt engineers to do inferior work that would threaten public health and safety." The argument was rejected. *National Society of Professional Engineers v. United States*, 445 US 679 (1978).

particular corporate trustee so much as 'he' has a particular intent about how he wants this trust to carry through its process."[13]

In modern times, removal clauses are reportedly more the rule than the exception. In fact, the author would like to believe that it is now generally recognized that a removal clause actively *promotes* the realization of the settlor's intentions by encouraging beneficiaries to oversee the administration of their trusts. Indeed, easing access to alternative corporate administration enhances competition for beneficiaries' accounts while discouraging corporate excess, thus promoting more cost effective administration?[14] David Rawson, a local lawyer with many years of experience as a senior level trust officer for a local bank and later president of an independent trust company summarizes the issue succinctly in a letter to the author.

> *Indeed, it can be fairly argued that though the intent of trust creators should be respected in all respects so long as within the bounds of public policy, nevertheless the dispositive intentions of the settlor should take precedence over administrative provisions. In particular, the choice of trustee must yield, all else equal, to the* <u>*beneficial*</u> *intentions of the creator. To assume otherwise would, in effect, put the cart before the horse. Because it is the beneficiaries who reap the fruits or bear the burden of the trustee's decisions, it is appropriate to accord them appropriate oversight over the trustee's actions so as to protect their own interests and, in effect, the interests of the creator (of the trust).*

<u>STRENGTHENING THE REGULATORY FRAMEWORK WHILE ENCOURAGING BENEFICIARY SELF HELP</u>

Is significant and timely improvement possible considering the influence of the industry in shaping banking legislation and its abhorrence for 'practical portability'? Perhaps not. But one point is clear. The sheer number and often the complexity of the questions that divide beneficiary and corporate trustee would seem to preclude attempts to solve each and every issue by specific statutory means. Nevertheless two complimentary statutory approaches are suggested - one emphasizing preventative medicine and a second designed to encourage self help by making it easier for beneficiaries to participate more actively in the management of their own trusts.

Illustrative Legislative Reforms Supporting A Stronger Regulatory Framework

- improve education of settlors/beneficiaries including investment fundamentals, rights/responsibilities of settlors/beneficiaries/trustees

[13] Mary Louise Fellows is an author and professor at the Law School of the University of Wisconsin and a consultant to the Restatement of Property (Second), Donative Transfers section of the American Law Institute. She was speaking at a meeting of the American Bar Association, Section of Real Property, Probate and Trust Law at the Plaza Hotel, NY on August 10, 1993.

[14] For further information, see *The Case for Portability of Personal Trusts*. April 15, 1995; and <u>Addendum</u>. April 20, 1995; Standish H. Smith, The Heirs® Organization.

- develop standards for setting fees/deduction of costs (e.g. adherence to a non-discriminatory fee rate structure, fixed/all inclusive rates as offered to the settlor)
- development of more detailed investment standards (safe harbors?) for the selection/performance of trust assets (e.g. use of index funds)
- develop standards for regulating communications between corporate trustees and beneficiaries (e.g. written timely responses to beneficiaries' written questions)
- set minimum disclosure standards for accounting statements (e.g. specify dates on which portfolio value is assessed for statement purposes, show how management fees computed, compare portfolio value from one reporting period to the next)
- promote the advertising of trust services including fees charged
- devise measures to reduce overlitigation by corporate trustees
- improve disclosure of actual corporate administrative practices including litigation records
- simplify the drafting/administration of trusts by eliminating/reducing the involvement of the IRS as a stakeholder (e.g. eliminate estate/gift taxes!)

Illustrative Legislative Reforms Directly Supporting Remedial Action By Beneficiaries

- offer beneficiaries veto power over specific administrative actions
- eliminate any burden of proof in removal cases (e.g. moving to a "no-cause" standard) including measures to insure prompt, low cost account transfer
- restructure the award of fees/costs in favor of beneficiaries (including punitive damages)
- promote court access (encourage courts to act on their own motion or on that of a special independent trustee)
- allow the sharing of signatory authority over the trust assets with beneficiaries

PROPOSED ADDITIONS/REVISIONS TO THE REVISED UNIFORM TRUST ACT

The revisions suggested below while not comprehensive in scope do illustrate the kind of changes that are needed to better balance interests of corporate trustees and beneficiaries.[15]

[15] The reader may wish to refer to actual text of the Revised Uniform Trust Act. To obtain a copy, contact Professor David M. English, W.F. Frather Endowed Professor of Law, University of Missouri – Columbia, Hulston Hall Columbia, MO 65221. Ph. (573)882-6854 or fax him at (573)882-4984.

Subject: **Removal of Trustee**
Comment:

Clearly the single most important reform is allowing trust beneficiaries practical means to switch corporate trustees easily without a burden of proof. It is important to point out that the corporate administration of personal trusts is commercial enterprise; hence those that choose to engage in such enterprise might be expected to bear some risk. Nevertheless, 'practical portability' need not pose any additional risk to a corporate trustee if unilateral resignation is an option exercisable at any time. In fact, a primary purpose is not to saddle a corporate trustee with unwarranted risk or costs but, indeed, to encourage same to step aside gracefully when requested to do so. It should be noted that the author has lobbied intensively for such practical portability in the Pennsylvania legislature from 1991-1995 without success despite hearings in both the Pennsylvania Senate and House, support from key legislators, and a massive write-in campaign. In the end, even the emasculated bill presented below providing basic corporate to corporate portability but nevertheless full of multiple loopholes could not overcome intense opposition from the banking interests!

Suggested revision:

AN ACT

Proposed Revised Text for Senate Bill 994

Amending Title 20 (Decedents, 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 beneficiaries of a trust, the creator of which is deceased, voting such that each income beneficiary shall cast two votes, each remainder beneficiary to cast one vote, *with a simple majority of votes to rule* and income interests
to break ties, a court of appropriate Jurisdiction shall remove and replace an incumbent trustee (individual, corporate or other entity) with a corporate trustee whether or not grounds exist for removal under section 7121 (relating to grounds and procedures).
(b) Representation--If there are no sui juris beneficiaries or if the remainder interests of any sui juris 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.
(c) Reasonable costs--An incumbent corporate trustee shall be entitled to reimbursement from the trust for its reasonable costs incident to a final accounting and asset transfer.
(d) 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.
(e) Release.--in the event a corporate trustee is removed under the provisions of this statute, he shall be released from responsibility for any past administrative or investment actions.

Section 2. This act shall take effect immediately

Comment:

Present drafting of the revised Uniform Trust Act does provide new grounds for removal if "…*investment performance* (is) *persistently and substantially below that of comparable trust*s." However present drafting incorporates imprecise language, imposes a requirement for substantial documentation on the beneficiary and invites a contest with the trustee. For example, what is *'investment performance'* (total return or capital gains?), what constitutes *persistent* substandard performance? What is performance that is '*substantially below*' that of comparable trusts? And what, pray, is a *comparable* trust? Suppose the trustee 'invests' in money market funds for five years running – is that grounds for removal of a corporate trustee who advertises its special skills' but not for an individual trustee?

Suggested revision:

> Grounds for removal shall include investment performance that has resulted in an equity (fixed income) total return gross of fees and other administrative costs less than __% (__%) respectively of a comparable index fund over a period of at least ___ years up to the current date.
>
> Explanatory Comment
>
> A 'comparable index fund' is one in which a __majority (__majority) of the equities (fixed income securities) constituting the securities portfolio of a trust currently appear. If more than one index fund meets this criterion, a 'comparable index fund' is defined as that fund with the smaller number of constituent issues.

In addition to removal for substandard investment performance, the revised Act now permits removal where circumstances existing at the time the trust instrument was drafted have changed and a replacement trustee would better serve the needs of the beneficiary. Although these additions are useful, they still impose a burden of proof on the beneficiary and therefore the prospect of a contest with an incumbent trustee.

***Subject:* Mediation of Disputes Via a Special Independent Trustee**

Comment:

Obviously not all disputes can (or should be) be resolved by removing the incumbent trustee. Yet experience indicates that a more practical means of dealing with everyday issues as well as removal is sorely needed. Unfortunately, beneficiaries are often apprehensive about raising issues with a bank administrator and, faced with the practical problems associated with contesting a particular administrative practice, do nothing. That's why a provision encouraging the court to act on its own motion in the mediation of disputes would be very helpful, particularly where beneficiaries lack the resources to find and then hire competent, independent counsel. Alternatively, provision might be made for the appointment of a special independent trustee to be selected by the beneficiaries subject to the approval of the court. A special trustee could be empowered to review the beneficiaries' complaints up to and including requests for removal or termination and recommend a course of action. In the event that removal (termination) was sought, grounds would follow those listed elsewhere in the Act. An incumbent trustee would, of course, be free to contest the findings of the special trustee but it is believed it would not be

likely to do so since the appointment would have been previously approved by the court. The allocation of costs would occur as provided elsewhere.
Suggested revision:

> Upon petition by a simple majority of the named, non-contingent, sui juris beneficiaries of a trust, the creator of which is deceased, a court shall approve the appointment of a special disinterested individual trustee with the discretion to review the acts of an incumbent trustee and to recommend to the court whatever changes may be appropriate including removal of an incumbent trustee or termination of the trust in order to serve the best interests of the beneficiaries.
>
> (a) Provided that the costs of the special trustee will be borne by the trust.
> (b) Provided that if there are no sui juris remaindermen or if the remainder interests of any sui juris remainderman be modified or eliminated by the exercise of another's petitioner's power of appointment, the court shall appoint a guardian or trustee ad litem to represent that remainder's interests.
> (c) Provided that if an election is made for removal, that no more than two removal proceedings may take place hereunder within any five year period.
> (d) Provided that if an election is made for removal, that a substitute trustee shall be a corporate trustee.
> (e) A removed corporate trustee shall be entitled to no terminal commission.
> (f) The apportionment of costs shall follow Section 1105 (as amended).
> (g) If it is found that the trustee has violated a duty owed to the petitioner and is at fault for doing so, the court may, in its discretion award punitive damages.
> (h) The trust assets plus all trust records, returns and reports of a removed trustee will be transferred within 60 days following the date on which a successor trustee accepts the trust.
> (i) Within 90 days of enactment, a corporate trustee shall notify all named, non-contingent, sui juris beneficiaries of irrevocable trusts it manages of the provisions hereof and of related provisions regarding the allocation of costs; said notification shall be repeated at least once every five years thereafter for the duration of all irrevocable trusts then managed.
> (j) In the event that a trustee is removed under the provisions of this act, that trustee shall be released from responsibility for any past administrative actions

Subject: **Attorney's Fees and Costs**
Comment:

Experience suggests that beneficiaries with corporate trustees are generally discouraged from pressing otherwise legitimate claims because they not only lack the necessary sophistication and financial resources but are apprehensive lest the corporate trustee tap the trust

for its defense expenses, perhaps even before court adjudication. Further, the trustee has sole signatory authority over the trust assets (whether or not a co-trustee is onboard) and hence is well positioned to impose its decisions by bluff or otherwise with little practical risk of a retaliatory response. Hence the next most important reform other than easier removal of an unsatisfactory trustee is the restructuring of the assessment of court and other costs in a manner that would recognize a) the profound disparity in financial resources between the parties[16] and b) eliminate the risk that trust assets (or even the personal assets of a beneficiary) could be taken to reimburse an incumbent corporate trustee for its defense costs, particularly with reference to a petition for removal. CA probate code has explicitly recognized the need to raise the bar as follows:

> "…the trustee of a trust that is not revocable that has refused to transfer administration of the trust to a successor trust company on request of the beneficiaries and the court in subsequent proceedings makes an order removing the existing trustee and appointing a trust company successor trustee, the court may, in its discretion, award costs and reasonable attorney's fees incurred by the petitioner in the proceeding to be paid <u>by the trustee</u> or from the trust…"

Suggested revision:

> In any event that the named, non-contingent, sui juris elect to petition the court for redress of any grievance, legal and other expenses shall be allocated as follows:
>
> (a) The reasonable legal expenses and costs of expert witnesses of the petitioners shall be borne by trust principal and those of an incumbent trustee shall be charged to said trustee.
> (b) If the trustee of a trust that is not revocable has refused to transfer administration of the trust to a successor trust company on request of a simple majority of the named, non-contingent, sui juris beneficiaries and the court in subsequent proceedings makes an order under removing the existing trustee and appointing a trust company as successor trustee, the court shall award costs and reasonable attorney's fees incurred by the petitioner in the proceeding to be paid by the trustee.
> (c) In no event shall a trustee be allowed to encroach upon trust funds to recover its legal expenses or other costs prior to court adjudication or prior to obtaining the written authorization of all qualified income beneficiaries.

Note the omission of the usual qualification that costs be awarded from the trust only if an action results in a benefit to the trust. Said omission is based on the presumption that the named, non-contingent, sui juris beneficiaries voting by simple majority unanimously for removal, will act in best interests of the trust.

[16]In fact if the bank's legal department needs a project to keep busy, it can simply stonewall an otherwise legitimate complaint at no out-of-pocket cost. Or it can simply drag matters along if it lacks the financial resources to settle in a timely manner. Much will also depend on whether the bank's liability policy covering such matters has a small deductible or not. (According to one spokesperson for a major nationally chartered bank, a small deductible will virtually guarantee that the bank will not settle soon.

Subject: **<u>Compensation of Trustee</u>**

Comment:

Corporate personal trust fee structures can only be characterized as chaotic. So called 'standard fee schedules' increase on the average every two-three years, typically without the consent of the beneficiaries. While fees to settlors on revocable inter vivos trusts can be said to be restrained by competitive forces, fees charged on testamentary trusts (of given size) are more apt to be controlled by factors such as a change in trust status from revocable to irrevocable, availability of a removal clause, presence of a co-trustee, the degree to which a beneficiary is assertive, other family monies potentially available for management, etc. Standard fee schedules, while ostensibly fully reflecting the fees charged for asset management, do not anticipate separate fees/costs imposed by the inclusion of foreign or domestic mutual funds in the portfolio. Such pricing strategy dispels any notion that administration fees charged on testamentary trusts are uniform among accounts of given size demanding an equivalent level of service. Further, unless previously counseled to demand a fee agreement, the settlor may not understand that his beneficiaries will have little practical control over the bank's charges.

Note also that, fee agreements executed by local banks on older trusts sometimes required the bank to justify fee increases on the basis of increased costs, stipulating that the bank must resign in favor of another bank if it could not do so. But in fact, one local bank refused to honor such an agreement saying that its costs had indeed increased. However fallacious its assertion on a per dollar of assets managed basis, the beneficiary chose to drop the matter rather than confront the bank in court. In another instance, the beneficiaries had voluntarily agreed to a previous fee hike and then were asked to accept another increase. The bank threatened to resign knowing that the beneficiaries would have difficulty in finding another local bank willing to manage their amount on a 3-4% of income basis. Had the beneficiaries stood firm (they did not), the bank likely would have continued to manage the account because a) the revenues lost would not have been offset by a similar or greater drop in its administrative costs and b) it is problematic whether a court would have approved a resignation request based solely on a fee issue. Lacking sophistication in such matters, the beneficiaries again approved the increase, probably because they wanted to preserve an otherwise harmonious relationship.

Listing a set of statutory criteria for evaluating the 'fairness' of a particular fee/cost as is current statutory practice is helpful but not a substitute for fees/costs set by an open, competitive marketplace. That's because many trusts are locked up accounts and challenging the fee rates/costs of a corporate trustee in court is not currently a practical remedy for most beneficiaries. On the other hand, some means should be available to mediate the obvious conflict between beneficiaries' desire for lower administration fees/costs against a corporate trustee's interest in higher fee rates and leave to pass on administrative costs formerly absorbed.

Suggested revision:

> A compensated trustee shall furnish the settlor of an irrevocable trust and the qualified named, non-contingent, sui juris beneficiaries with a dated schedule of fees/costs which shall be a) fixed as to absolute amount or (alternatively) as to rate in the case of fees calculated on income/principal and b) inclusive of all ordinary or usual services provided for a period of at least fifteen (15) years from date of funding subject to the terms of any

written agreement previously executed between the trustee and settlor/beneficiaries. Any modification of said fee schedule based on an expansion of services beyond those originally contemplated must be approved by the unanimous consent of the named, non-contingent, sui juris beneficiaries. After the initial fifteen year period has expired, a compensated trustee may demand a change in level of compensation with the proviso that if the unanimous agreement of the named, non-contingent, sui juris beneficiaries is not forthcoming, it will agree to resign without contest in favor of a substitute trustee to the nominated by and then approved by them and the court.

***Subject:* Duty of Loyalty**

Comment:

The conversion of common trust funds and even individual securities held within a trust portfolio into a proprietary mutual fund is a breech of the duties-quoting the 1999 April 19th, draft of the Revised Act - "… to incur only necessary costs of administration…" and to balance "…projected benefits against the likely costs" since the benefits conferred to the beneficiary are negligible and do not begin to offset the increase in costs/fees incurred. And it is self dealing because using common trust fund assets and individual securities to jump start proprietary mutual funds conveys material benefits to the corporate trustee but not the beneficiary. It is also arguably a breech of the duty to "…keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust…". That's because annual disclosure (via the fine print of a prospectus) regarding "… the rate and method by which the compensation was determined…" is not equivalent to disclosure of the actual fees/costs charged each reporting period. It is also a breech because of the lack of process involved in selecting a proprietary mutual fund over other investment alternatives. Rather than carve out an exception for proprietary mutual funds simply because most states (under pressure from the banking interests) have passed enabling legislation, conversions should be prohibited unless a) conversion is approved by unanimous vote of the qualified beneficiaries b) any additional administrative costs/fees over those incurred by a precursor common trust fund are fully rebated, and c) a written explanation is provided to how and why the purchase of shares in the bank's proprietary fund better meets the objectives of the trust than other alternative investments.

Comment:

It is not uncommon for a trust instrument to direct the trustee to examine a beneficiaries' other resources before allowing distributions of principal and/or income. Such provisions can be useful, for example, in optimizing the allocation of trust income among several beneficiaries or in promoting trust growth by discouraging the distribution of principal absent a clear need for same. However, allowing a trustee to demand (rather simply request) such information is an invasion of privacy and offers the corporate trustee the freedom to (unfairly) promote the interests of one beneficiary against another by demanding such information in one instance but not another. In particular, such provisions allow a corporate trustee to access the financial resources of a potential litigant. Hence they create a conflict of interest and should be prohibited as not in the public interest.

***Subject:* Duty to Inform and Report**

General comment:

Beneficiaries are entitled to material information relevant to the administration of their trusts. If so, can it also be agreed that beneficiaries should enjoy such access without having to ask for same and/or without the expense of forcing production? Would not beneficiary oversight be encouraged by doing so?

Comment:

In fact, experience suggests that corporate trustees often do not provide clear, prompt and responsive replys to material questions posed by beneficiaries.

Suggested revision:

> The trustee shall proffer a relevant, written response in clear English within 14 business days following receipt of a beneficiaries' written inquiry and shall do so normally without charge. However, if the information requested requires an extraordinary amount of research and the trustee declines to provide same gratuitously, the trustee shall a) characterize and summarize what is required to provide a relevant response, b) furnish a reasonable estimate of the man hours required to meet said request and c) quote a cost per hour.

Comment:

Is there a valid reason why a trustee should not <u>always</u> deliver a copy of an irrevocable instrument within a reasonable length of time following funding without a special request? If so, such reasons should be detailed.

Suggested revision:

> Following funding, trustee shall promptly provide every sui juris beneficiary of an irrevocable trust with a copy of the trust instrument unless explicitly prohibited from doing so under the instrument or under the following circumstances: to wit _____

Comment:

Fees/costs assessed on mutual funds held within a trust account are disclosed within the prospectus for a particular fund but not (as far as is known) on periodic statements supplied by banks to beneficiaries. Further, fees taken at the account level do not generally show the method of calculation. For example, a local bank currently discloses only its total advisory fee. Not disclosed is the fee rate (i.e. # of basis points), the amount of income/principal on which said fee is assessed nor the date on which income/principal was valued for fee purposes. Separate co-trustee fees are not broken out. While the portfolio is valued as of the current reporting period, the exact date corresponding to said value is not reported. Nor are the complete holdings of its common trust or mutual funds disclosed (presumably for competitive reasons). Thus independent checks of the fee calculation and/or the value of trust portfolio under such circumstances is impossible.

Suggested revision:

> For each reporting period, a trustee shall disclose
>
> - all administrative costs/fees including those allocated against principal/income for funds held within a trust portfolio on an unbundled basis.
> - the method of calculation (i.e. the formula) and the component values used in the calculation of all fees/costs assessed.
> - the identity of the individual securities held within any fund (common trust fund, mutual fund, limited partnership) and the size of each holding.

Comment:

Beneficiaries might reasonably expect that a bank's published fee schedule would apply to all of its administered trusts of whatever description (revocable vs. irrevocable, inter vivos vs. testamentary, etc.). Nevertheless, experience suggests that a bank may entertain more than one standard schedule simultaneously and may not even bother to date same. Nor do standard schedules limit or even fully define what costs may be deducted from trust income/principal from time to time.

Suggested revision:

> A corporate trustee shall disseminate to all named, non-contingent, sui juris beneficiaries not more than one fee/cost schedule during a given period and that schedule shall be dated and inclusive of all costs/fees charged. Periodic accounting reports shall include a statement that the fees/costs charged are in accordance with a prior agreement between the parties or, in the absence of same, are currently the same as for all other clients having trusts of similar size. If the fee/costs charged vary from the trustee's standard schedule, the statement shall include an explanation thereof.

Comment:

The duty to provide advance notice under given circumstances should not be restricted to transactions affecting a significant portion of the value of the trust property. Secondly, allowing an exception for property whose market value is readily ascertainable (by the beneficiary) is useless unless the beneficiary has available independent means of determining that a sale, etc. is contemplated. Thirdly, what possible circumstances or objective criterion can be used to judge whether the mere *announcement* of a pending sale - as opposed to a sale itself - etc. would be seriously detrimental to the interests of the beneficiaries. Further, in the event that disclosure is forbidden by law, it would be preferable to disclose at least the fact that a transaction was imminent which cannot be identified under law and then identify the state/federal statute in question. Finally, advance notice of any transaction should always be given unless the property in question consists of publicly traded securities held within a well diversified portfolio comprising less than (say) 5% of the total value of the trust assets.

Suggested revision:

> A trustee shall always inform the named, non-contingent, sui juris beneficiaries at least __ business days in advance of the sale, purchase, barter or other disposition of any trust property with the exception of publicly traded securities held within a widely diversified portfolio compromising less than __% of the value of the trust assets unless such disclosure is prohibited under law. In the latter case, timely notice will be given that a transaction is pending involving certain trust assets which under ___ (cite applicable state/federal statute) cannot be made known in advance to the beneficiaries.

Comment:

Experience suggests that beneficiaries often have little clue as to whether their trust investments are performing well or not. Introducing a requirement that the trustee report on same would be helpful.

Suggested revision:

> A corporate trustee will furnish the named, non-contingent, sui juris beneficiaries a timely comparison of the total return (gross of all fees/costs) on at least a quarterly basis against that of a comparable index fund. (A comparable index fund is one in which a __ majority (__ majority) of the equities (fixed income securities) constituting the trust portfolio currently appear. If more than one index fund meets this criterion, a comparable index fund is defined as that fund with the smaller number of component issues.

Comment:

It is routine for a corporate trustee to request a release from the remainder interests at the termination of a trust or in the event of a change of trustees. However, such requests are sometimes inappropriate because remainders either may not have any knowledge of their interest or, more typically, cannot judge the efficacy of the trustee's administration because they have never received copies of the trust instrument, accounting statements, etc. Further, experience suggests that a corporate trustee will delay distribution pending receipt of same.

Suggested revision:

> *A corporate trustee shall furnish the following statement when requesting a release from any remainder (income) interests in connection with a trust that is terminating under the terms of the instrument or being transferred to a substitute trustee not named in the trust instrument.*
>
> *"We would appreciate it if you would sign and return the enclosed release to us promptly. However, there is no obligation for you to do so. Failure to do so will not delay distribution of any funds or other property that might be due to you at this time nor affect any decision on our part to demand a court accounting prior to distribution."*

Subject: **Delivery of Property By Former Trustee**

Comment:

A corporate trustee interested in maintaining its fee base has available a number of strategies for doing so. For example, experience suggests that a corporate trustee typically will request a release from the remainder interests when a trust terminates by court order or under a provision in the trust instrument. Similarly, a release by the income beneficiaries is typically requested whenever an incumbent trustee is removed and replaced by a substitute trustee. Failure to obtain same promptly often delays distribution of trust corpus. Further delay may occur if the trustee elects to petition for a court accounting prior to distribution or demands a 'termination fee' where same is not specifically authorized by the instrument. Pending an agreement, the trustee may also convert common trust fund 'units' or other assets to money market funds or refuse a needed partial distribution. Consequently, remainders anxious to receive their legacy can be pressured to sign a receipt and release even though they have not had access to accounting statements (or perhaps even the trust instrument) during the lifetime of the trust. Under such circumstances, how are remainders to determine whether they have a cause of action or not prior to signing? Similarly, experience suggests that income beneficiaries hoping for a prompt transfer of the trust assets to a substitute corporate trustee can and do face distribution delays of a year or more.

Suggested revision:

> Upon termination of a trust by court order or the terms of the trust instrument or in the event that a former trustee is replaced, a former trustee having custody of the trust assets shall effect transfer of same to the remainders or substitute trustee in kind (unless units are held in common trust funds) within a period not to exceed 60 business days unless extraordinary circumstances prohibit doing so. In such event, the trustee shall a) reserve only that amount of trust corpus as required by such extraordinary circumstances for an additional period not to exceed __ business days and b) fully document the need to delay transfer to the remainders (income beneficiaries). Such extraordinary circumstances shall not be predicated on a trustee's petition for a court accounting or its failure to obtain either a release from the remainders (income interests) or an agreement regarding the charging of a termination (transfer) fee. The costs of a court accounting shall be borne by the trustee (the trust) if requested by said trustee (a majority of the income beneficiaries).

Subject: **Provision to Allow Change of Situs**

Comment:

A provision allowing the named, non-contingent sui juris beneficiaries to change the legal situs of a trust could be of significant advantage to beneficiaries. For example, state statutes vary in a) the degree of protection afforded against creditors, b) application of the rule against perpetuities, c) state and other (local) taxes imposed on trust income/principal as well as d) criteria for removal of a trustee or trust termination. By changing situs, beneficiaries could take advantage of laws that would promote more effective administration, particularly with regard to

laws governing trustee removal. If a trust is created for the exclusive benefit of the beneficiary, then it would seem reasonable, barring specific direction in the instrument to the contrary, to allow beneficiaries to petition the court for a change of situs. In such event an incumbent trustee should have to agree not to contest a beneficiaries' motion in this respect.

Whether an incumbent trustee may continue to administer as a foreign corporation upon a change of situs presumably depends on whether the two states in question would permit same as, for example, if an agreement existed between themselves allowing each to manage trusts sited in the other's jurisdiction. Under existing rules, for example, it is understood that beneficiaries may petition to have a trust sited in Pennsylvania managed by a corporate trustee located in New Jersey (and visa versa) because of a reciprocity agreement between the two states. In such event, obviously, the trust situs may not correspond to the geographic location of the trustee. Nevertheless a trust administered by a local corporate trustee could continue to be *administered* by that trustee but under the laws of a different state. Thus while a state might or might not suffer a loss in taxes following a change of situs, an incumbent corporate trustee could continue to reap its administrative fees. Hence an incumbent corporate trustee would not necessarily be predisposed to challenge same.

Suggested revision:

> The situs of the property of any trust may be maintained or changed to any jurisdiction in the absolute discretion of the named, non-contingent sui juris beneficiaries voting _____________ with or without the approval of the trustees of said trust. Upon any such transfer of situs, the trust estate may thereafter, at the election of the beneficiaries of such trust voting ________, be administered exclusively under the laws of (and subject to, as required, the exclusive supervision of the courts) the jurisdiction to which it has been transferred. In the event of a change of situs, the trustees are hereby relieved of any requirement of having to qualify in any other jurisdiction and of any requirement of having to account in any court of such other jurisdiction.[17]

Subject: **Repayment of Expenditures**

Comment:

Experience suggests trustees sometimes threaten a court accounting in order to gain leverage over beneficiaries. To avoid such situations, it is suggested that such costs be allocated against the entity or individual(s) requesting same.

Suggested revision:

> All costs (court filing fees, legal expenses, etc.) associated with a court accounting will be paid by the trustee whether requested by the court or the trustee and by the trust if requested by the beneficiaries unless a court determines that the trustee has seriously breached its duty in which case it may order such costs to be paid by the trustee.

[17] Text largely excerpted from an article entitled *Changing Trust Situs: The Legal Considerations of Forum Shopping* by Sligar, J.S., Trusts and Estates, July 19, 96, p. 41.

Subject: **Remedies for Breech of Trust**

Comment:

The availability of punitive damages and jury trial can be important to securing the interests of beneficiaries if only as a means of encouraging representation by counsel in disputes involving smaller trusts. In fact "…punitive or exemplary damages have been awarded in a number of circumstances involving fiduciaries" as Dominic Campisi points out in his forthcoming book entitled A *Legacy of Litigation.* As Campisi also notes, the jury trial is currently available in some jurisdictions (e.g. Georgia).

There is also a need to make a distinction between an individual trustee who would probably decline to serve if exposed to such remedies and a corporate trustee which serves only to make a profit. Thus the provision in the revised Act reciting that "…the remedies of a beneficiary are exclusively equitable and, as such, do not include either punitive damages or jury trial…" should only apply to trustees serving without compensation. Would banks be converting common trust funds into proprietary mutual funds at the present rate if punitive damages and the jury trial were available as remedies?

Subject: **Nonjudicial Settlement Agreements**

Comment:

As banks continue to merger, a question arises as to whether agreements/policies - whether in written or oral form - between a beneficiary and a prior trustee are binding on a successor trustee. It would seem that a successor trustee should be bound if, to quote Dominic Campisi in his unpublished *A Legacy of Litigation* (p.213), "… courts have followed the principal that purchase or consolidation does not create an entire new entity but, to paraphrase the expression of a court of a sister state (CA), merely directs the blood of the old corporation in the veins of the new, the old living in the new … [Estate of Barriro, Cal App. 153, 176 (1923)].

Suggested revision:

> Upon the merger, purchase, consolidation, etc., of one corporate trustee into another corporate trustee, any existing agreements whether written or oral (the latter as evidenced by actual administrative practice) between a predecessor corporate trustee and the beneficiaries of that trust shall be upheld by the successor trustee, binding the successor with the same force as the predecessor trustee. A trustee may be removed by the court if it refuses to honor any such prior agreement.

Subject: **Limitation of Action Against Trustee Following Trustee's Report**

Comment:

Since beneficiaries cannot be presumed to have the necessary sophistication to protect their own interests or the financial resources to hire qualified counsel, the burden should be on the trustee to make full and complete disclosure. In this respect, the statement or report of the 'claim' should indicate that the beneficiary is under no obligation or sanction to respond to said report/statement and generally he/she should not do so other than to request further information (in writing) to be provided within a stated, reasonable time period.

Suggested addition:

> *______ trustee has made (is contemplating) the decision/action described herein which may or may not impact your interests as a beneficiary. In compliance with _____ (Uniform Trust Act or other regulatory authority), we are today informing you of this fact. You need not provide any relevant information to us either orally or in writing since to do so may impact your rights to contest this decision/action at a later time. Nevertheless, you have the right to make further inquiries of us regarding this matter. And we agree to provide you with a responsive written answer within 20 days of receipt of your question. Further, be assured that your questions cannot be used as evidence that you knew of the said decision/action or could/should have inquired into its existence as of a certain date.*

***Subject:* Provision to Allow Court To Act On It's Own Motion**

Comment:

In the event of a dispute with a corporate trustee, the beneficiary may have a legitimate cause of action but lack expertise or financing to pursue his/her claim, particularly if a bank elects to contest the beneficiaries' petition. In such event, the court should be persuaded to act on its own motion to resolve the dispute.

Suggested revision:

> In particular, when it is apparent to the court that the beneficiary lacks the resources to press his/her claim against an incumbent corporate trustee, the court may act on its own motion in an effort to resolve same.

***Subject:* Provision to Allow Termination of an Uneconomical Irrevocable Trust Without the Expressed Consent of the Trustee**

Comment:

The termination of an uneconomical trust should not be contingent on the approval of a corporate trustee where the value of the trust is < $50000 since fees/costs may easily exceed 1.5% annually, especially where trust corpus is invested in a proprietary mutual fund.

Suggested revision:

> If a trust meets the definition of an uneconomical trust as provided elsewhere, and agreement cannot be reached with the named, non-contingent, sui juris beneficiaries voting _______ regarding the costs of administration, either the trustee or said beneficiaries voting ______ may elect to terminate said trust.. In the event that the trust is terminated, said beneficiaries voting ________ may elect a replacement trustee of their own choosing.

SUMMARY AND CONCLUSIONS

So long as moving a personal trust account remains a costly, time consuming and threatening proposition and beneficiaries are denied full information, it can be anticipated that settlor's expectations will continue to be compromised and beneficiaries will continue to be exploited by bank trustees. Unfortunately, as long as banks rely on referrals from drafting lawyers, drafting lawyers look to banks for trust forms, a recommendation to serve as a co-executor/co-trustee as well as for other business and law firms contribute to judicial election campaigns, too many trust/estate practitioners are likely to support the status quo rather than support reform. Arguably a trust is created for the exclusive benefit of the beneficiaries. That said-the named, non-contingent, sui juris beneficiaries, speaking collectively and virtually are likely to have a more accurate view as to what constitutes the best interests of a trust than a corporate trustee or even a settlor since circumstances may have either changed or been unknown to him at the time of drafting. Of course, in practical situations, beneficiaries may make the wrong decision say, for example in the investments arena. That's why beneficiary education is also key to reform and why a mechanism is needed to provide beneficiaries with sufficient information so as to allow them to protect their own interests. May the author suggest that such information should be made available without request or other conditions and should not depend on whether or not a particular transaction involves a significant share of the trust corpus or is in some way unusual? But until this millennium arrives, it would be of immediate help if corporate trustees were required to supply beneficiaries with an annual 1041, reveal the content of discussions/correspondence with the settlor, co-trustees or other beneficiaries, and reply responsively to beneficiaries' questions in writing within a reasonable time period. (Of course the latter should be conditioned by ground rules as to what constitutes proprietary or excessive information). Further, fees/costs charged for bank administration of personal trusts will almost certainly continue to accelerate unless corporate trustees are bound to a fixed, all inclusive fee schedule permitting rate increases only when justified by <u>objective</u> standards such as improved investment performance/service and then only with the consent of the named, non-contingent, sui juris beneficiaries.

That is not to say that courts could not be a positive force in maintaining temperate trustee-beneficiary relations. In this connection, it would be helpful if the American Rule were enforced against corporate trustees and/or if invasions of corpus for legal, accounting or other undisclosed expenses were prohibited without prior beneficiary consent. It would even help if courts would mediate disputes on their own motion or, alternatively, if an unbiased, competent forum could be made available where disputes concerning communications, fees, investment issues and dispositive matters could be handled necessarily sans the assistance of legal counsel. But as things stand, the self interest of a corporate trustee and the leverage enjoyed by a corporate trustee to enforce that interest often detracts from its duty of loyalty to the beneficiary. That's why the playing field needs to be leveled by new rules which not only offer beneficiaries means of practical oversight but which, at minimum, insure that beneficiaries can always vote with their feet if need be! And if the corporate trustee feels that such reforms would jeopardize the profitability of continued administration, why not guarantee the privilege of unilateral resignation perhaps even accompanied by a (mandatory?) release under appropriate circumstances. Until then beneficiaries are well advised to heed a chapter heading in Dominic Campisi's forthcoming book on trust litigation—to wit, "If You Shoot At the King, Don't Miss!"[18] Let's be clear about one point. The court system does not—repeat <u>*does not*</u>—

[18] From *A Legacy of Litigation, Probate and Trust Litigation*, Campisi, Dominic.J., 1997 (Unpublished).

presently offer a practical remedy for the diversity of problems that personal trusts impose on beneficiaries.

The author does not pretend to have the final answer. But the fact that a bizarre grassroots movement called Heirs® could incite the media to the tune of over 120 print articles plus radio and local national TV coverage speaks to the reality of the problem, a problem that affects perhaps 4M beneficiaries.[19] Perhaps the time has arrived for a serious, systematic evaluation of corporate trust administrative practices! Do you agree?

[19] How many beneficiaries have bank managed personal trust accounts, and what percentage are dissatisfied? Both numbers are elusive but the Federal Financial Institutions Examinations Council does report that U.S. financial institutions providing personal trust administration numbered 849211 accounts averaging about 1M per account as of December 31, 1997, such accounts being those over which the bank had discretion for investment of the trust assets. If each account has say 3-5 named, non contingent sui juris beneficiaries, then perhaps we are talking roughly 4M beneficiaries. But what percentage are dissatisfied? While some 2400 individuals have contacted Heirs® since 1991 purely as a function of media exposure, 2400 is a tiny fraction of an estimated 4M beneficiary pool. The more interesting question is whether 2400 (mostly dissatisfied beneficiaries) unhappy beneficiaries represents the whole iceberg or just its tip. In this connection, the Office of the Comptroller's Customer Assistance Group (CAG) logged 715 complaints about bank's fiduciary activities from 4/98 through 4/99. Indeed, the author believes that if more beneficiaries were educated about matters fiducial and had practical means to seek more cost effective administration, a much greater fraction would seize the opportunity to seek better administration. One thing is certain. Prospective settlors typically steer clear once they learn the facts about bank administrative policies!