

STANDARDS OF PRACTICE: TRUSTEES

Adopted by the
MINNESOTA ASSOCIATION FOR
GUARDIANSHIP AND CONSERVATORSHIP

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**MINNESOTA ASSOCIATION FOR
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M A G i C
An Organization to Explore Substitute Decision-Making**

STANDARDS OF PRACTICE: TRUSTEES

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I. INTRODUCTION

A “trust” is a legal agreement that provides for the management and distribution of assets. A trust is created by the transfer of property by the owner (referred to as the “settlor” or “grantor”) to another (the “trustee”). A trustee can be a professional fiduciary, a trust company, or a relative or friend. The trustee holds title to the property and manages the property for the benefit of the beneficiaries. The beneficiaries may be one or more individuals and may change over time depending on the circumstances and the language of the trust document.

A TRUST IS NOT THE SAME AS A CONSERVATORSHIP- Trustees and conservators both act as fiduciaries and must comply with high standards of conduct. However, the two roles are very different. A trustee is generally appointed by the individual who establishes the trust and a conservator is appointed by the court. In contested matters or where settlor-nominated Trustees are unavailable, a trustee may also be court-appointed. A trustee’s job description is defined by the trust document (with reference to state law where needed) while a conservator’s duties and responsibilities are governed by the order appointing the conservator and state law.

Upon appointment it is imperative that the trustee begin by carefully reading the trust document. The trust document should be consulted regularly, particularly any time a question arises. The trust is the trustee’s road map, and the trustee must follow its directions about when, whether and how to distribute principal and income, and what reports the trustee needs to make to beneficiaries.

II. DEFINITIONS

Beneficiary: The person or persons for whom the trust assets are managed. The identity of the beneficiary/beneficiaries may change over time; therefore a trustee’s fiduciary responsibility extends not only to current beneficiaries, but also to future or remainder beneficiaries.

Settlor: The person who establishes the trust and places property under the control of the trust document. Also known as a “grantor.”

Inter-Vivos: An Inter-vivos or “living” trust is a trust created during the settlor’s lifetime.

Res/Corpus/Principal: These terms are used to define the property controlled by the trust agreement.

Remainder Beneficiary: A remainder beneficiary is the individual, individuals or entities who stand to benefit from the trust estate after the primary purpose of the trust has been accomplished or the primary beneficiary has died.

Testamentary Trust: A testamentary trust is one created under the terms of an individual’s will.

Trustee: The person who is charged with managing and distributing the property for another’s benefit.

Trust Amendment: Any change to the terms of the trust, generally executed by the settlor and delivered to the trustee.

Trust Reinstatement: An amendment to the trust terms, made by restating the trust agreement in its entirety.

Trust Protector: One or more persons having authority to change the terms or direct the manner of administration of a trust to further the purposes of the trust.

III. TYPES OF TRUSTS

There are many different types of trust. It is important that the trustee understand the specific nature of the trust being managed. The following are those trusts most likely to be encountered by a professional fiduciary:

Living Trust: A living (inter-vivos) trust is a trust established during the settlor's lifetime and is often revocable. Typically, the settlor will act as trustee, but if the settlor becomes incapacitated or dies, a successor trustee steps in to manage the trust assets. A living trust is often used as a primary estate planning tool because it can effectively manage the settlor's property for his or her benefit during life and can also provide for distribution or ongoing management after death. Property in a living trust passes at the settlor's death (or later) according to the trust's terms and without the need for a probate proceeding.

Minor's Trust: Because assets cannot legally pass directly into the hands of a minor, trusts may be used to avoid the need for a separate conservatorship proceeding or protective order, e.g., at the death of a parent. A trust for minor children (either testamentary or inter vivos) can be used to manage assets for the child's benefit until they reach a certain age. A trust can also assure that the assets are used for specific purposes (e.g., education).

Supplemental Needs Trust: A supplemental needs trust is established for the benefit of a person with a disability. A supplemental needs trust is funded by someone other than the trust beneficiary; for that reason, supplemental needs trusts are sometimes referred to as third-party special needs trusts. Assets held in a supplemental needs trust are considered exempt for purposes of public benefit eligibility. Remaining assets after the beneficiary passes away, generally, are not subject to the State payback provision.

Special Needs Trust: A special needs trust is a trust established for the sole benefit of, a person with a disability younger than 65 by the individual with a disability, a parent, grandparent, guardian, or court. Once established, the trust must only be funded with assets and income that belong to the beneficiary. A special needs trust must state that, at the death of the beneficiary, any remaining trust assets will be distributed first to the state as repayment for any Medical Assistance received by the beneficiary. When these requirements are met, the assets held in trust are not considered available to the beneficiary for purposes of public benefit eligibility, and the transfer of the beneficiary's assets into the trust is not penalized. See Section V.F for additional information.

Discretionary Trust: A fully discretionary trust authorizes the trustee to pay to the beneficiary only as much of the income or principal of the trust as the trustee determines is appropriate, with the remaining income or principal reserved for another purpose. This discretion allows the trustee to give the beneficiary some benefits under the trust or to give the beneficiary nothing. The beneficiary cannot force the trustee to use any of the trust property for the beneficiary's benefit. Such a trust gives the beneficiary no interest that can be transferred or reached by creditors until the trustee has decided to pay or apply some of the trust property for the beneficiary. The trustee of a fully discretionary trust will need to understand the beneficiary's situation (e.g. reliance on public benefits) and the motivation of the settlor in establishing the trust.

Credit Shelter/Disclaimer Trust: A credit shelter trust is often part of an estate plan for married couples who have estates that exceed state or federal estate tax limits. The credit shelter trust is established to protect the estate tax exemption of the first spouse to die. A credit shelter trust typically requires that all of the income generated by the trust assets is paid out to the surviving spouse. On the death of the second spouse, the assets in the trust pass to beneficiaries named in the trust document without being taxed as part of the estate of the second spouse to die.

Charitable Remainder Trust: Charitable remainder trusts are used to make charitable donations and realize tax savings for an estate. Typically, the grantor or settlor will transfer property (such as real estate, artwork, etc.) to the trust for the continued benefit and enjoyment of the beneficiary. At the beneficiary's death, the

property passes to a charity and the donor's estate receives a reduction in taxes due from the estate.

Irrevocable Trust: An irrevocable trust, by its terms, cannot be modified or terminated by the settlor once it is established. The primary reason for establishing an irrevocable trust is for estate and tax considerations. Transferring property into an irrevocable trust removes ownership from the settlor.

Pooled Trust: A pooled trust is a special or supplemental needs trust for the benefit of a person with a disability. The distinction between a special needs trust and a pooled special needs trust is who acts as trustee. A pooled trust must be administered by a non-profit organization that 'pools' the various subaccounts for multiple individuals with disabilities in order to maximize investment returns.

IV. DUTIES OF A TRUSTEE

The duties of a trustee are found in the trust document as well as in the law. The following is a summary of duties generally imposed on a trustee. Keep in mind that the trust document itself or applicable local law may contain contrary provisions.

A. Duty to Administer the Trust According to its Terms Minn. Stat. Sec. 501C.0801

The trustee must administer the trust in accordance with its terms, as found in the trust document, and for the benefit of the beneficiaries of the trust. This overriding duty is spelled out in more detail below.

B. Duty to Act in the Interest of Beneficiaries Minn. Stat. Sec. 501C.0802

The trustee is obligated to administer the trust solely for the benefit of the beneficiary. Commonly described as the duty of loyalty, the trustee cannot put the interests of the trustee or anyone else over the interest of the beneficiary.

1. The trustee owes no duty to the settlor or creator of the trust unless the settlor is also a beneficiary of the trust.
2. The trustee must avoid any conflicts of interest or the appearance of a conflict of interest. The trustee must not engage in self-dealing, such as investing trust asset in the trustee's personal business, selling assets to the trust, purchasing assets from the trust, or borrowing from the trust. Self-dealing also includes transactions with persons close to the trustee, like relatives or business associates, even if there is an appraisal or other favorable benefits to the trust. Court approval should be sought to address a self-dealing issue. It is not self-dealing for the trustee to take a reasonable fee for its fiduciary services, subject to any limitations in the trust agreement.
3. Acting for the benefit of the beneficiary requires knowing the beneficiary's needs, especially if the beneficiary is disabled and needs assistance advocating for him or herself. As part of knowing the beneficiary's needs or educating the beneficiary about the trust, a trustee should meet with a beneficiary as least annually, or more often as appropriate.

C. Duty of Impartiality When Dealing with Multiple Beneficiaries Minn. Stat. Sec. 501C.0803

When the trust has multiple beneficiaries, the trustee must deal impartially with all beneficiaries, unless the trust document says otherwise. See C.2 below. In other words, the trustee must not show bias toward any one beneficiary. This duty of impartiality applies both within a class of beneficiaries as well as between classes of beneficiaries, such as current vs. future beneficiaries.

1. The investment of assets is an area that can raise the issue of impartiality. For example, investments made to maximize income at the expense of growth, or vice versa, may raise a claim of impartiality between primary or income beneficiaries and contingent or residual beneficiaries.
2. Special needs trusts for people with disabilities often expressly provide that the primary beneficiary's interests are of utmost importance, and that the trustee should make decisions without concern for remainder beneficiaries.

D. Duty to Keep Assets Separate

Trust assets must be kept separate from the trustee's personal assets as well as separate from the assets held in other trusts.

1. All trust assets should be titled in the name of the trust.
2. When dealing with trust matters the trustee should sign as trustee. Example: John Smith, as trustee of the Jane Doe Trust.

E. Duty to Manage Assets Carefully Minn. Stat. Sec. 501C.0804

The trustee only has authority over assets transferred into the trust. Understanding what assets the trust holds is the first step in administering the trust assets appropriately.

1. The trustee has the duty to take and keep control of trust assets. In some situations, this duty may include making sure an asset is properly titled as a trust asset.
2. The trustee has the duty to preserve trust assets. This duty would include the duty to safeguard valuables, maintain adequate insurance on assets and even dispose of improper investments and reinvest them in a more suitable investment. See Paragraph 5 below.
3. The trustee has the duty to enforce claims in favor of the trust, but is not obligated to commence legal action when the anticipated costs of litigation exceed the expected return, or when the prospect of success is low. Court approval of the trustee's decision may be advisable. The trustee shall contact an attorney, as appropriate to the situation.
4. The trustee has the duty to take all reasonable steps to defend the trust against a claim. Settling a claim may be a reasonable action if the cost of defending the claim exceeds the costs of settlement. The trustee shall contact an attorney, as appropriate to the situation.
5. The trustee has the duty to invest and manage assets as a prudent investor would, by considering the purposes, terms and other circumstances of the trust. Stated another way, the trustee is obligated to use "such care and skill as a person of ordinary prudence would

use in dealing with his or her own property.” How assets are to be invested and managed by a trustee can be found in the Prudent Investor Rule which has been codified in Minn. Stat. Sec. 501C.0901. A summary of the Prudent Investor Rule follows:

- a. The Prudent Investor Rule applies to all trustees who manage or invest assets except to the extent the trust terms or the court alters its application.
- b. An investment or management decision with regard to individual assets must be evaluated in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives suited to the trust. The factors that a trustee can consider in making investment decisions include:
 - 1) The general economic conditions,
 - 2) The possible effect of inflation,
 - 3) The expected tax consequences,
 - 4) The role each investment or course of action plays within the overall portfolio,
 - 5) The expected total return from income and appreciation of capital,
 - 6) Other resources of the beneficiaries known to the trustee,
 - 7) The needs for liquidity, regularity of income and preservation or appreciation of capital,
 - 8) An asset’s special relationship or value to the purposes of the trust or the beneficiaries, if consistent with the trustee’s duty of impartiality.

Minn. Stat. Sec. 501C.0901 Subd. 2

In addition, a trustee must diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust would be better served without diversifying. Minn. Stat. Sec. 501C.0901 Subd. 3. The theory behind diversifying trust assets is that it reduces the risk of overall investment losses. That being the case, a trustee should consider obtaining court approval for a decision not to diversify trust assets, as well a decision to embark on a controversial plan of investment.

- c. A trustee can be protected from liability if the trustee meets the procedural requirements of the Rule, even if the investment outcomes are not satisfactory. The key is to establish and then follow a written procedural plan for investing and managing trust assets. The plan for investments should detail asset allocations, strategies to achieve diversification, any obstacles to diversification or other trust goals, and a schedule of how and when any obstacles are addressed or eliminated.
- d. Upon appointment, the trustee should obtain a clear understanding of the beneficiaries’ circumstances and the trust terms. With that understanding in mind, the trustee should review the trust assets and bring the trust portfolio in compliance with the trust purposes, terms, distribution requirements and other circumstances of the trust and with the requirements of the statute. Minn. Stat. Sec. 501C.901.

- e. The trustee should conduct ongoing review and monitoring of trust investments, review all account statements on a monthly basis and develop a timeline to evaluate trust performance and determine whether the plan continues to meet plan objectives. The trustee should also adopt a plan to rebalance asset allocations, typically using a periodic or percentage approach. As a general rule, periodic rebalancing should occur every 6 to 12 months. Changing circumstances, however, may dictate rebalancing more frequently, and a trustee needs to be able to respond accordingly.
- f. The trustee must maintain good records. This should include written plans and procedures as well as records of ongoing reviews, monitoring of the plans and also communications relating to those efforts.
- g. The trustee must maintain knowledge of the trust provisions, statutes, (such as Minn. Stat. Sec 501C.0901) and be aware of any changes or amendments; the trustee should periodically re-read the trust and resist the urge to rely on memory. Likewise, the trustee should review the statute periodically and be aware of any changes or amendments.
- h. A trustee should hire competent professional advice, especially investment advisors, tax advice and legal advice. See paragraph V.C below.

6. The trustee should pay bills and file taxes in a timely manner.

F. Duty to Make Trust Property Productive

As a general rule, the trustee has a duty to invest trust property so that it produces an income (e.g. interest, dividends, etc.). If an asset cannot produce income, the trustee should replace the asset in favor of one that produces income, unless the asset serves a particular purpose that outweighs the obligation to make it productive.

G. Duty to Maintain Detailed Records and Provide Accountings Minn. Stat. Sec. 501C.0810 and 501C.0813

- 1. The trustee should keep records of all of transactions including deposit records and receipts for purchases. Not only are the records needed to complete the accountings, but beneficiaries are entitled to review these records upon request.
 - a. The duty to keep good records is especially important with regard to a trustee's billing records.
 - b. A trustee is entitled to receive a reasonable fee for services provided to the trust (Minn. Stat. Sec. 501C.0708), unless the trust agreement specifies otherwise. If the terms of the trust specifies a trustee's compensation, the court can allow more or less compensation, depending on the duties undertaken by the trustee and the reasonableness of the compensation specified in the trust.
- 2. The trustee is generally obligated to provide accountings to the beneficiary, and to provide information which is needed by the beneficiary to protect his or her interest. The trust

document usually indicates who receives accountings and how often. Absent contrary language in the trust document, accountings are usually provided to the settlor and all beneficiaries on an annual basis.

- a. A beneficiary is usually prevented from later raising objections to actions by the trustee if the beneficiary received adequate disclosure in the annual accounting. Therefore, a thorough accounting can limit the trustee's later exposure to claims by a beneficiary.
- b. If a trust is court supervised, accountings are filed with the court and provided to the beneficiaries in a court mandated format. See Form 417.02 of the Probate Rules of the General Rules of Practice for the District Courts.

H. Duty upon Termination of the Trust

1. A trust can be terminated in accordance with its own terms, when there are no assets remaining in the trust, or when it is no longer cost effective to maintain the trust. Whether court approval is needed to terminate the trust depends on why the trust is being terminated.
2. When a trust is to be terminated, the trustee has such duties as are appropriate to wind up the trust. This includes the obligation to preserve the trust assets until the trustee has made final distribution.
 - a. Upon termination of the trust, the trustee is obligated to transfer title of trust assets to the beneficiaries or transfer possession to the beneficiaries, if an asset has no title.
 - b. Prior to the final distribution of trust assets, the trustee should provide a final accounting to the beneficiaries. Consent by all beneficiaries to the final accounting or court approval, as appropriate, should be sought.

V. OTHER CONSIDERATIONS

A. MN ABLE Account

1. MN ABLE Account is a tax-advantaged account that an eligible individual can use to pay for qualified disability expenses (found on the Social Security Administration POMS Manual). The Beneficiary is owner of their own MN ABLE Account. An Attorney-In-Fact can be designated as an account representative and manage account on behalf of the beneficiary. Account owners must have been blind or disabled before age 26. There can only be one MN ABLE Account per person, with a total yearly contribution(s) to the account not exceeding \$15,000 (as of 2019). Collectively, assets in the ABLE Account exceeding \$100,000 are considered available for the purpose of SSI resource determinations. Similar to a Special Needs Trust, MN ABLE Accounts have a payback provision to the State. Any assets remaining in account after beneficiary's death are subject to recovery by the State of Minnesota Department of Human

Services for benefits paid to the beneficiary. Beneficiaries and/or their advocates and representatives should maintain good records (receipts) of expenses should they need to provide them to Social Security or IRS.

B. Tax Returns

1. If applicable, the trustee must file annual income tax returns for the trust. The trustee should hire competent tax counsel to prepare the returns and provide advice to the trustee. Along with filing the tax returns, the trustee must provide appropriate tax information to the beneficiaries each year when distributions are made or as appropriate.
2. Trusts frequently have their own federal tax identification number which the trustee obtains upon appointment to serve as trustee. Tax counsel can give advice on whether a tax identification number is needed.

C. Court Supervision

1. Some trusts are court supervised and some are not. If a trust is established by the court or with court approval, or if the trustee or any beneficiaries request, the trust will almost always be supervised by the court. When supervised by the court, annual accountings are required to be filed with the court and heard periodically, the frequency of which depends on court rules. Courts may require that a trustee of a supervised trust be bonded.
2. The advantage of court supervision includes judicial approval of accountings (to cut off later objections to the accountings), and having the opportunity for the court give direction to the trustee on issues that are expected to be contentious, or subject to second-guessing by a beneficiary. Court supervision can also be advantageous when construction (or interpretation) of the trust document is needed. Obtaining a ruling for the court and following the court's ruling will absolve the trustee from liability for its actions.

D. Hiring Professionals to Assist the Trustee

A trustee is entitled to hire professionals such as lawyers, financial advisors, brokers, accountants, appraisers, real estate agents, case managers, or other professionals as appropriate to meet the needs of the trust or its beneficiaries. The trustee can pay for these professionals with monies from the trust.

Before hiring a professional, the trustee should:

1. Check the professional's qualifications. Many professionals must be licensed, certified or registered by a government agency. Check credentials with the government agency. Make sure the license or registration is current and the professional is in good standing. Check the professional's history.
2. Interview the professional thoroughly.
3. Before hiring any professional, get a proposed plan of work and expected fee.
4. The Securities and Exchange Commission provides tips for choosing a financial professional at www.sec.gov/investor/alerts/ib_top_tips.pdf.

E. Delegation by Trustee Minn. Stat. Sec. 501C.0807

A trustee may delegate to another person any duties or powers that a prudent trustee of comparable skills could properly delegate under the circumstances. Prior to delegating duties or powers, a trustee must use care in selecting an agent and establish the scope and terms of the delegation. The trustee must also monitor the actions of the agent throughout the agent's term of access to the trust

F. Special Issues Relating to Special Needs and Supplemental Needs Trusts

Although the previously noted general rules apply to Special and Supplemental Needs Trusts, these trusts require careful consideration of their unique requirements. Because these trusts have the essential purpose of improving the quality of the disabled trust beneficiary's life while at the same time keeping the beneficiary eligible to receive government benefits, the trustee's central duties include understanding the purpose of the trust, what government benefits the beneficiary is currently receiving, and how the overseeing government agency (county economic assistance (Medical Assistance), Minnesota Department of Human Services or Social Security Administration) oversees or interprets the trust. In addition, the tax implications of these trusts (whether a tax identification number or separate tax returns are needed) are more complicated.

Some points to keep in mind that relate to Special Needs Trusts:

1. A Special Needs Trust must be drafted and administered for the sole benefit of the disabled beneficiary.
2. If the beneficiary is receiving Medical Assistance, a copy of the Special Needs Trust document and an inventory of trust assets with values must be filed with the Special Recovery Unit of the Minnesota Department of Human Services. In addition, annual accounts must be filed with the same state agency.
3. Upon termination of a Special Needs Trust, the trust will specify who receives the balance of the trust after any permissible recovery for benefits paid on behalf of the beneficiary. The payment of the trustee's administrative expenses may be more restrictive in comparison to other trusts.

G. Discretionary Distributions

A discretionary distribution is one the trustee makes when the trust does not specify the amount or the specific item of distribution. As an example, trust provision authorizing a discretionary distribution may say: "The trustee is authorized to pay to or for the benefit of the beneficiary for the beneficiary's education, as the trustee deems appropriate." This trust provision does not indicate the amount of the distribution or what the distribution can be for, other than "education." It is up to the discretion of the trustee to determine appropriate amount of the distribution and what constitutes "education."

In determining how to exercise discretion, the trustee needs to determine the settlor's intent. The settlor's intent should be gleaned from trust document and if uncertainty remains as to the settlor's

intent, intent can be determined from the facts and circumstances that existed when the trust was created.

After gathering the relevant information needed to make a discretionary distribution decision, a trustee is well advised to document the process and the outcome. Records should be retained of the communications made with the beneficiaries about discretionary distribution decisions.

A trustee or beneficiary may seek court guidance or approval of a trustee's exercise of discretion, however, the court typically will not interfere with a trustee's exercise of discretion unless it finds fraud, bad faith or an abuse of discretion by the trustee.

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