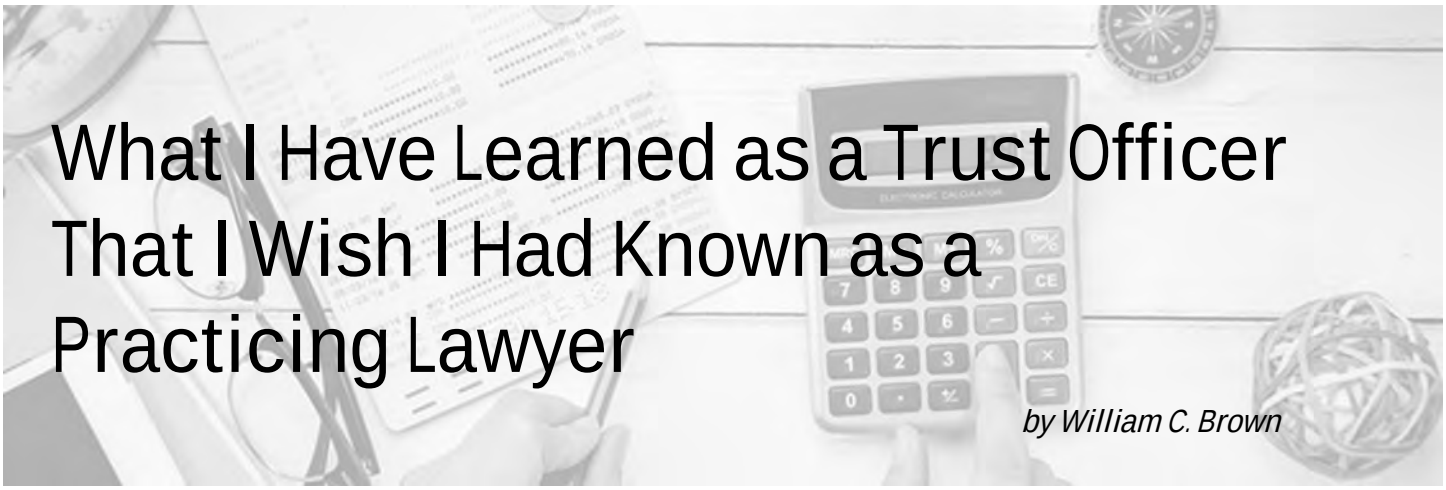

What I Have Learned as a Trust Officer That I Wish I Had Known as a Practicing Lawyer

by William C. Brown

On January 1, 2019, after 33 years in private law practice,[1] I became a Trust Officer for a state-chartered Nebraska trust company. Over the next year, I learned a significant amount about trust business and about trust administration and practical drafting issues. The following is offered in the hope that current estate planning practitioners may benefit from my experiences.

Trust Business

Overview

Ongoing[2] trust business is conducted either through Nebraska-chartered trust companies;[3] trust departments of Nebraska-chartered banks;[4] or foreign trust companies or departments.[5] The focus here is on Nebraska-chartered trust companies, as the law applicable to them is seminal as to the others.

The Nebraska Trust Company Act[6] is the main applicable statute. It gives general supervision and control over trust companies to the Nebraska Department of Banking and Finance ("NDBF").[7]

William C. Brown

William C. Brown joined Bridges Trust Company after a 33-year career in private law practice, focused mainly on financial areas of the law (estates/trusts, estate administration, business, contract, commercial, pensions/employee benefits, mergers/acquisitions). He graduated from the University of Iowa (B.G.S. 1982 with highest distinction, Phi Beta Kappa; J.D. 1985 with distinction, *Iowa Law Review*).

Entity Organization

A trust company must be formed as a corporation[8] by at least three incorporators.[9] The name of the trust company may not cause confusion with others.[10] Generally, only qualified trust companies may use the term "trust" in their names.[11]

There must be at least five directors,[12] a majority of whom must be Nebraska residents,[13] and as many as reasonably possible of whom should be from the county of the trust company's location.[14] Directors must be people of good moral character, known integrity, business experience and responsibility, who must be approved by NDBF.[15] Directors must meet at least quarterly and must keep written minutes of meetings.[16]

Trust companies must have capital of at least $500,000.[17] They also must maintain a fidelity bond in an amount to be fixed by NDBF.[18] The bond protects and indemnifies the trust company from loss via dishonest acts committed by its own officers and employees.[19]

Trust companies also must pledge securities with NDBF.[20] The amount required to be pledged varies depending on the amount of assets the trust company holds.[21] The largest amount is $500,000 for trust companies holding assets of $5 billion or more.[22] The pledged securities are primarily liable for trust companies' fiduciary obligations and losses.[23]

Powers

Trust companies have the following powers:

- To receive, hold, manage, and invest trust assets.[24]
- To act as personal representative of estates.[25]

- To act as conservator.[26]
- To act as attorney-in-fact/agent.[27]
- To act as UTMA custodian.[28]
- To act as retirement plan trustee and IRA custodian/trustee.[29]
- To loan[30] and borrow[31] money.

Trust companies may deposit securities with clearing agencies and other organizations and such securities may be held in bulk in the name of a nominee.[32]

Restrictions

Trust companies (and entities generally) may not act as agent/attorney-in-fact under health care powers of attorney.[33] Trust companies may not substitute their own securities for those of a trust or estate.[34] Loans of trust company assets or accounts may not be made to trust company officers or directors.[35] Trust company lawyers may not charge a fee for giving any legal advice.[36] Real estate conveyances made by the trust company must be approved by the directors or a board committee and by the trust company's president or vice president.[37]

Regulation, Reporting, Disclosure

Trust companies are subject to significant regulation and reporting/disclosure requirements, including the following:

- Annual internal examination. At least annually the board must conduct a thorough examination of the books, records, funds and securities held for the trust company and customer accounts.[38] The board may instead engage an accountant or accounting firm to conduct an audit.[39] The accountant/firm must be preapproved by NDBF.[40] Extensive audit guidelines apply.[41]
- Bi-annual report. Each January and July, trust companies must file with NDBF verified reports of the trust company's condition.[42] NDBF has issued forms and instructions for these reports.[43] Summaries of the reports must either be published or made available to the public upon request.[44]
- NDBF regulation. NDBF has broad-ranging authority to examine and investigate trust companies.[45] NDBF can levy assessments[46] and collect fees,[47] suspend or revoke licenses for failure to pay the same,[48] impose fines,[49] issue injunctions,[50] exercise emergency powers,[51] and take over a failing institution.[52] NDBF must approve change of trust company main office location,[53] establishment of trust company branch[54] and representative[55] trust offices, acquisitions of control,[56] and mergers/consolidations.[57]
- Other. Trust companies may maintain confidentially of client information with some exceptions.[58] Records must be maintained in accordance with applicable regulations.[59] Trust companies are subject to the Financial Data Protection and Consumer Notification of Data Security Breach Act of 2006.[60]

Policies and Procedures

My firm has in place the following policies and procedures:

- Information Security Policy
- Identity Theft Prevention Policy
- Business Continuity and Disaster Recovery Plan
- Anti-Money Laundering Policy
- Conflict of Interest Policy
- Ethics Policy and Code
- Privacy Policy

NDBF requires the firm to train employees on these policies, and to present a comprehensive compliance review and risk assessment to the board, at least annually.

My firm implements the following additional physical security measures: redundant office entry security systems, overnight "clean-desk" and locked-doors/drawers policies, automatic personal computer log-off after twenty minutes of inactivity, end-of-day copy room security procedures, required shredding of discarded documents with confidential information, and multi-layered security for entry to vault containing original documents.

Trust and Estate Administration

A significant part of my firm's activities involves the administration of trusts and estates. My firm has formed a specific committee, the Trust and Estate Administration ("TEA") Committee, that meets bi-weekly, and as needed, to discuss legal and administrative issues that arise in the course of trust and estate administration. The committee keeps minutes of its meetings and decisions, which minutes are reviewed by NDBF.

The TEA Committee reviews estate and trust documents prepared by many lawyers and firms. In that process, a variety of drafting and practice issues have arisen. Those are discussed in the next main section of this article.

Drafting and Practice Issues

1. Discretionary Trust Distributions Based on Some Standard. Many trusts allow distributions to be made if some standard is met (need, maintain current standard of living, etc.). Our TEA committee will investigate and determine whether the trust's stated distribution standard is met. We may require the beneficiary to complete beneficiary needs state-

ments, which may include financial statements (balance sheet, income/cash-flow statements), tax returns, etc. This helps ensure compliance with the grantor's intent and protection of remainder beneficiaries' interests.

Practicing attorneys may want to inform their clients of this administrative practice. Clients may want to advise remainder beneficiaries of this (assuming the client otherwise discloses the estate plan to remainder beneficiaries).

2. Rule Against Perpetuities. A surprising number of recently-drafted Nebraska trusts that we see continue to recite the common-law rule against perpetuities. Nebraska has adopted the Uniform Rule Against Perpetuities Act.[61] It allows a trust to mostly waive the rule.[62]

On the other hand, it may be desired, and it is possible, to shorten the otherwise-applicable perpetuities period. In at least one case, a trust we administered did just that, calling for imposition of a period of time intentionally shorter than that required under the particular state's statutory rule against perpetuities.

3. Special Needs Issues. A frequent source of confusion and misunderstanding involves drafting and planning for special needs trust beneficiaries. In our experience, special needs issues cut-across all categories of society.

A common drafting error is to confuse first-party, or self-settled, special needs trusts ("SNTs") with third-party SNTs. Self-settled SNTs are generally funded with assets deemed to be those of the special needs individual. Third-party SNTs are generally funded with assets deemed not to be those of the special needs individual.[63] Properly-drafted first-party SNTs will include a right for relevant governmental agencies (e.g., Medicaid) to recover trust assets upon the death of the special needs individual.[64] Third-party SNTs need not include such a right of recovery.[65] We have seen third-party SNTs that erroneously include a right of governmental agency recovery, when that is not necessary and may prevent assets from descending to trust beneficiaries.

Estate planning attorneys who are dealing with known special-needs individuals, but who are not familiar with the intricacies of SNTs, would be well-advised to associate with attorneys who are. This may be an ethical obligation under applicable rules of professional conduct.[66] It may also be advisable to include fail-safe SNT language in all trusts in the event any trust beneficiary may become a special needs individual in the future.

4. Name Testamentary Trusts. Some testamentary trusts created within wills are not named. Giving the trust a name is helpful to the trust company. It avoids the awkwardness of having to refer to the trust only by the name of the testator, the date of the will, and the particular section of the will that creates the trust.

5. Avoid "Revocable" And "Living" In The Names Of Trusts. Using the terms "revocable" and "living" in the name of inter vivos trusts can cause confusion when the trust becomes irrevocable, for example, upon grantor's death or incapacity.

6. Define "Disability" and "Incapacity". Disability/incapacity status can impact all three major parties to a trust. If a grantor of a revocable inter vivos trust becomes incapacitated, the trust generally becomes irrevocable. If an individual trustee or co-trustee becomes incapacitated, that person should no longer act as trustee. If a beneficiary becomes disabled or incapacitated, distributions that could otherwise be made outright may need to be directed elsewhere or retained in trust. If a disabled/incapacitated beneficiary could qualify for public assistance, stand-by SNT provisions may be triggered.

In each of these situations, trustees can be significantly aided if the trust document itself contains definitions of "disability" and "incapacity" for all these purposes.

7. Define Trustee Succession Procedures. The Nebraska Uniform Trust Code does have a fail-safe provision for establishing acceptance of trusteeship.[67] However, our experience is that the statutory methods are cumbersome, and that it is preferable for trusts to specify procedures for assumption of office

by successor trustees. This is especially true if there could be real estate conveyances.

8. Accurately Name Trustee. Mis-naming the corporate trustee can cause undue complications. Again, this is especially true if there could be real estate conveyances.

9. Urge Clients to Update Documents for Changed Circumstances. A significant portion of the difficulties we face as trustee involves planning that has not been updated to reflect clients' changed circumstances. This can take a variety of forms, including: client no longer is, or has become, subject to federal estate tax; a trust beneficiary has become, or no longer is, a special needs individual; client moves from one state to another; or marital and other family changes.

10. Account Titling. Effective estate planning should include consideration of assets that may pass by beneficiary designation and co-ownership. Pour-over wills generally cannot direct those assets to a trust.

11. Co-trustees. Clients sometimes insist on acting as individual co-trustee. In those situations, it is very helpful if the trust document sets out, as specifically as possible, the allocation of duties between the individual and the corporate trustee.

12. Form Documents. Form documents may save time and cost over custom-drafted documents in the short run. However, we have seen them cause at least as many problems as they solve. Some issues we have seen include: language not in accordance with current applicable law, form language that contradicts other language in the same document, and form language that contradicts the grantor's desires. The more custom, individualized language that can be drafted, the better.

13. Inter Vivos Gifts as Offset. If the client has made significant, unequal inter vivos gifts, it is best to document in each planning document thereafter whether or not the gifts are intended as an offset to ultimate trust (or estate) distributions.

14. Trusts as Recipient of Retirement Plan Assets. The tax and other law regarding trusts' receipt of retirement plan assets is extraordinarily complex and beyond the scope of this article. As a very general matter, if the estate plan can be implemented without placing retirement plan assets in a trust, that is preferable. If it is deemed advisable to place retirement plan assets in a trust, great care, consideration, analysis, and pre-planning should be taken. The use of trusteed IRAs may be a viable alternative, along with beneficiary designation forms that can be lawyer-drafted and customized to fit clients' particular planning needs.[68]

15. Pre/Post Nuptial Agreements. Successful implementation of an estate plan may depend on effective waiver of spousal inheritance rights. That can be accomplished in pre-[69] or post-[70] nuptial agreements. This is especially true in subsequent marriages.

16. Personal Property. The difficulties of dealing with tangible personal property in estates were generally known to me as a private practitioner. However, those difficulties were highlighted all the more to me as a trust officer of a corporate trustee. Use of corporate trustee time and efforts to dispose of tangible personal property can be inefficient and unwise. Disposition of such property other than through trusts can be preferable. Alternatives exist, such as collection/disposition by affidavit,[71] or informal probate,[72] if necessary. If a corporate-trusteed trust will end up holding tangible personal property, a complete and detailed list as to the property's disposition is strongly preferred.[73]

17. Choice of Law/Situs. It can be helpful if trusts do not immutably specify a particular body of substantive law that applies or a particular situs. That allows the trust to adjust either or both facets in order to avail itself of better laws, changed circumstances, changed location of grantor and/or beneficiaries, and the like. A more flexible approach is to state that the trustee may change the situs and applicable substantive law of the trust.

18. Joint Trusts. The use of joint trusts in community property states is common and consistent with a clear income tax advantage in community property states: all trust assets can receive a basis adjustment upon the first spouse's death.[74] The use of joint trusts in non-community property states can raise a number of legal and tax issues, including the extent to which basis-adjustment applies, and to which assets. Trust provisions addressing the basis-adjustment issue in particular can be very helpful to the Trustee.

19. Principal and Income Act. There are two aspects of the Uniform Principal and Income Act[75] that merit particular attention:

> a.) Trust income versus principal. Traditionally, trusts differentiate between income and principal. Especially with income yields at near-historic lows, alternative means have become timely and more prevalent. Practitioners' familiarity with concepts such as the power to adjust between principal and income,[76] and conversion to a total return trust,[77] can be helpful, both at the drafting and administration stages.
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> b.) Retirement plan distributions to trusts. The Principal and Income Act provides that trust receipts of required retirement plan distributions are to be allocated 10 percent to income and 90 percent to principal.[78] To the extent the distribution is not required, the entire amount is allocated to principal.[79] This can result in the trust-accounting principal amounts[80] being subject to income tax at trusts' very-compressed income tax rates.[81] Fortunately,

this unappealing income tax result can be avoided. One of the simplest ways is to override the Principal and Income Act provision by a trust provision setting out a different accounting convention (e.g., all retirement plan distributions received by the trust are trust-accounting income).[82]

20. Nebraska Uniform Directed Trust Act. Nebraska adopted the Uniform Directed Trust Act on September 1, 2019.[83] The Act sets out legal standards for trust directors[84] and directed trustees,[85] and delineates other duties and liabilities of those parties.[86] Incorporation of the Act's standards into trust documents can be of assistance especially when a corporate trustee is asked to be directed as to trust investments. This can occur, for example, when the client wishes to retain the client's long-time investment advisor despite assets being held by the corporate trustee.

Conclusion

Trust companies are financially secure, well-capitalized, extensively regulated, highly trained professional fiduciaries. Trust companies are storehouses of legal knowledge and practical administrative experience. Both during trust drafting and administration, trust companies can provide invaluable assistance to private practitioners and thereby to estate planning clients.[87]

Endnotes

1 My private law practice included ERISA, trust, estate and probate, business, mergers/acquisitions, contract, tax, and commercial matters.

2 *See also* Neb. Rev. Stat. § 30-3820, requiring foreign corporate trustees to qualify as foreign corporations if the principal place of administration of a particular trust is in Nebraska.

3 *See* Nebraska Trust Company Act, Neb. Rev. Stat. §§ 8-201 to 8-235.

4 *See* Nebraska Banking Act, Neb. Rev. Stat. §§ 8-159 to 8-162.02; NAC §§ 45-21-001 to -003.

5 *See* Interstate Trust Company Office Act, Neb. Rev. Stat. §§ 8-2301 to 8-2313. *See also* 12 U.S.C. § 92a.

6 *See supra* note 3.

7 Neb. Rev. Stat. § 8-201. *See also* Neb. Rev. Stat. § 8-103(1)(b).

8 Therefore, the Model Business Corporation Act ("MBCA"), Neb. Rev. Stat. §§ 21-201 to 21-2,232, applies.

9 *See supra* note 7.

10 Neb. Rev. Stat. §§ 8-1901 to 8-1903 and 21-230(b).

11 Neb. Rev. Stat. § 8-226.

12 Neb. Rev. Stat. § 8-204.

13 *Id*. (unless NDBF approves otherwise).

14 *Id*.

15 *Id*. NDBF has issued a form to apply for approval as a director. *See* "Application for Approval of a Director" at https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/industries/DirApp2018.pdf.

16 Neb. Rev. Stat. § 8-204.

17 Neb. Rev. Stat. § 8-205(1) (for trust companies initially authorized after August 1, 2000).

18 Neb. Rev. Stat. § 205.01. Our trust company has about $5.3 billion assets under management and just under 50 employees, and it is required to maintain a $15 million bond with a $150,000 deductible.

19 Neb. Rev. Stat. § 8-205.01.

20 Neb. Rev. Stat. §§ 8-209 to 8-217.

21 Neb. Rev. Stat. § 8-209(2).

22 Neb. Rev. Stat. § 8-209(2)(e).

23 Neb. Rev. Stat. § 8-212.

24 *See, e.g.*, Neb. Rev. Stat. § 8-206(1) – (3), (6), (8), (11), 8-1302 & 1303.

25 Neb. Rev. Stat. § 8-206(5).

26 *Id*.

27 Neb. Rev. Stat. § 8-206 (4) and (7). This allows trust companies to act as agents under durable financial powers of attorney. *See* Neb. Rev. Stat. § 30-4002(1) and (7). *But see* text accompanying note 31.

28 Neb. Rev. Stat. § 43-2710(1)(a)(i).

29 See IRS Rev. Proc. 2019-4, § 3.07; Treas. Reg. §§ 1.408-2(e)(1) – 1.408-2(e)(8).

30 Neb. Rev. Stat. § 8-206(8).

31 Neb. Rev. Stat. § 8-206(11).

32 Neb. Rev. Stat. § 8-1302. *See also* Neb. Rev. Stat. § 1303 as to deposit of United States Government securities with the federal reserve bank.

33 Neb. Rev. Stat. §§ 30-3402(1) & (3).

34 Neb. Rev. Stat. § 8-224.01(1).

35 Neb. Rev. Stat. § 8-224.01(2).

36 Neb. Rev. Stat. § 8-224.01.

37 Neb. Rev. Stat. § 8-208.

38 Neb. Rev. Stat. § 8-204. The board may assign this task to a non-board member, but the board by majority vote must adopt the assignee's report. NAC § 45-24-001.0. The board may also perform the examination throughout the year. NAC § 45-24-001.09.

39 Neb. Rev. Stat. § 8-204.

40 *Id*. *See also* NAC § 45-24-001. Independence is a key issue. NDBF has an online form for approval of the accountant/firm, at https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/industries/Approval%20to%20Conduct%20Audit%20or%20DirectorsExamRev%202017.pdf.

41 *See* NAC § 45-25-001.

42 Neb. Rev. Stat. §§ 8-223, 8-224.

43 *See* https://ndbf.nebraska.gov/industries/trust-company-forms.

44 Neb. Rev. Stat. § 8-224. *See also* https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/doc/industries/trust_annual_disclosure.pdf.

45 Neb. Rev. Stat. §§ 8-108, 8-201.

46 Neb. Rev. Stat. §§ 8-601, 605, 606.

47 Neb. Rev. Stat. § 8-602.

48 Neb. Rev. Stat. § 8-607.

49 Neb. Rev. Stat. § 8-1,134.

50 Neb. Rev. Stat. § 8-1,136.

51 Neb. Rev. Stat. § 8-1,134(3).

52 Neb. Rev. Stat. § 8-1506.

53 *See* https://ndbf.nebraska.gov/sites/ndbf.nebraska.gov/files/industries/appmovemainoff-indtrustco.pdf.

54 Neb. Rev. Stat. § 8-234.

55 Neb. Rev. Stat. § 8-235. See https://ndbf.nebraska.gov/files/industries/trustformA_0.pdf.

56 Neb. Rev. Stat. §§ 8-1501, 1502.

[57] Neb. Rev. Stat. §§ 8-227 to 8-229.03.

[58] Neb. Rev. Stat. § 8-1401.

[59] NAC § 45-32-001.

[60] Neb. Rev. Stat. §§ 87-801 to 808.

[61] Neb. Rev. Stat. §§ 76-2001 to 76-2008.

[62] Neb. Rev. Stat. § 76-2005(9). Trust property must be salable for any period of time beyond the otherwise-applicable perpetuities period.

[63] *See generally* 42 U.S.C. § 1396p(d).

[64] *See* 42 U.S.C. § 1936p(d)(4)(A).

[65] *See* 42 U.S.C. § 1396p(d)(2)(B).

[66] Neb. Ct. R. of Prof. Cond. § 3-501.1, comment [1].

[67] Neb. Rev. Stat. § 30-3857.

[68] My firm sponsors only trusteed IRAs, and welcomes custom, lawyer-drafted beneficiary designation forms.

[69] *See* Neb. Rev. Stat. § 42-1004(1)(c).

[70] *See* Neb. Rev. Stat. § 30-2316(a). *See also Devney v. Devney*, 295 Neb. 15, 886 N.W.2d 61 (2016).

[71] Neb. Rev. Stat. § 30-24,125.

[72] Neb. Rev. Stat. §§ 30-2414 to 2424.

[73] Neb. Rev. Stat. § 30-3844.

[74] 26 U.S.C. § 1014(b)(6).

[75] Neb. Rev. Stat. §§ 30-3101 to 3149.

[76] Neb. Rev. Stat. § 30-3119.

[77] Neb. Rev. Stat. § 30-3119.01.

[78] Neb. Rev. Stat. § 30-3135(c).

[79] *Id.*

[80] To the extent they are income-taxable as income in respect of decedent (*See* 26 USC § 691) and do not represent investment in the contract (*see generally* 26 USC § 72).

[81] 26 U.S.C. § 1(e).

[82] Neb. Rev. Stat. § 30-3118 (a) (1) allows the trust to override a contrary provision of the Act. For a detailed discussion of this topic, see "Life and Death Planning for Retirement Benefits," Natalie B. Choate, ATaxPlan Publications (2019), at pp. 395-402, §§ 6.1.02-6.1.04.

[83] Neb. Rev. Stat. §§ 30-4301 to 4319. Note the effective date/applicability provisions of § 30-4319.

[84] Neb. Rev. Stat. § 30-4308.

[85] Neb. Rev. Stat. § 30-4309.

[86] *See, e.g.*, Neb. Rev. Stat. §§ 30-4310, 4311, 4312.

[87] The author wishes to acknowledge and express gratitude for the efforts of his cohort, Jeanne Hauser, for her assistance in the preparation of this manuscript.