Diff'rent Strokes for Diff'rent Folks (or Trusts)

Investment approaches for different types of trusts, with administrative and fiduciary considerations

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Speaker Bios

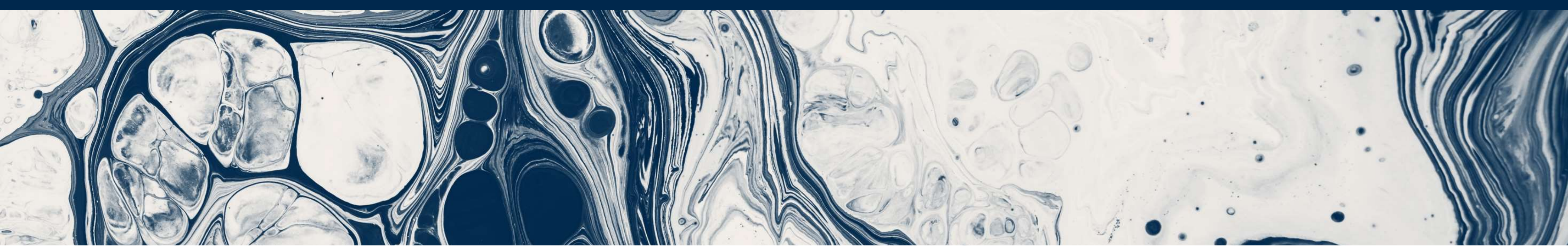
TIM RILEY is a founding shareholder of Aguirre Riley P.C., a full-service law firm with offices in Las Vegas and Reno with a significant focus on the following areas: advising individuals and families on sophisticated tax and wealth transfer issues and related wealth planning issues including wealth management and preservation; trust and estate administration; philanthropic planning; foundation management; business succession planning; marital agreement planning and family office management. Tim is a current member of the Nevada State Bar Legislative Committee for Probate and Trust Section and a former chair of both the Nevada State Bar Probate and Trust Section and the Estate Planning Council of Northern Nevada, and he has been recognized as a Top Ranked Attorney by Nevada Business Magazine and a Mountain States Super Lawyer. Tim obtained his JD and LLM in Taxation from the University of Denver, and he is admitted to practice in Nevada and Colorado.

STACEY DELICH-GOULD is a Senior Vice President and Director of Trust and Estate Services for Capital Group Private Client Services/Capital Bank and Trust Company, focusing on trust, estate, tax and personal planning matters. Before joining Capital in 2018, Stacey spent more than 10 years in private legal practice, with Sullivan & Cromwell LLP, Cahill Gordon LLP, Venable LLP and most recently as a partner at Morrison Cohen LLP in New York. Stacey received her JD from New York University School of Law (cum laude), her LLM in taxation from New York University School of Law and her BA from Tufts University. From 2005–2006, Stacey was the New York University School of Law Tax Policy Fellow, during which she worked at the U.S. Department of Treasury.

Stacey is a registered TEP (of the Society of Trusts and Estates Practitioners) and in 2018 was elected a Fellow of the American Counsel of Trust and Estate Counsel (ACTEC). She was named a 2011–2012 John S. Nolan Fellow by The American Bar Association Section of Taxation. Stacey is a frequent speaker at various bar association and professional organization meetings and has held numerous leadership positions in such organizations.

Agenda

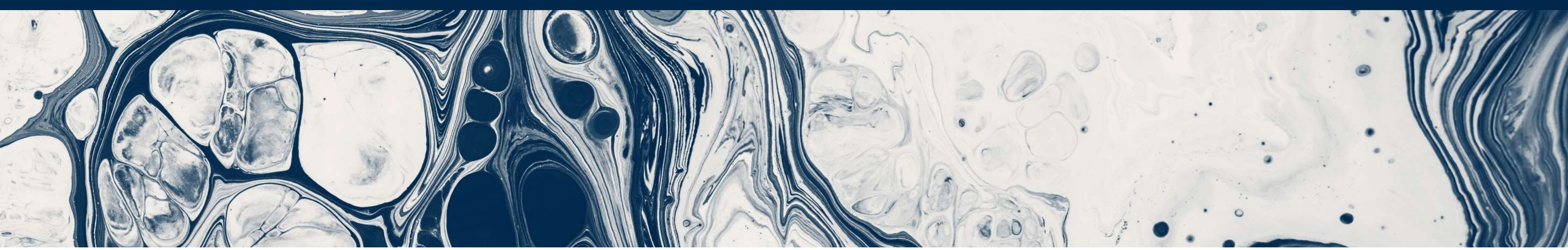
Three stages of investing trust assets



Three stages of investing trust assets

- Phase 1: Develop the plan (Investment Policy Statement, “IPS”)
- Phase 2: Implement the plan (Administrative Considerations)
- Phase 3: Monitor the plan (Fiduciary Considerations)

Phase 1: Develop the plan



Phase 1: Develop the plan (IPS)
Review the trust document

- Trust structure and objectives
  - Simple or complex?
  - Type of trust?
  - Underlying Purpose/Reason for Creating the Trust?

- Timeline, to the extent known
  - What needs to happen every year?
  - What particular dates, events or circumstances will cause something to happen?
  - What do we know about when the trust will terminate? Perpetuities period? Likely lifespan?

Phase 1: Develop the plan (IPS)
Review the trust document

- Distribution provisions
  - Any required distributions?
  - Any ascertainable standards?
  - Discretionary distributions? What guidance is provided?
  - Any beneficiary powers of withdrawal?

- Any beneficiary powers of appointment?
  - General or limited?
  - Specific requirements for validity?

Phase 1: Develop the plan (IPS)
Review the trust document

- Administrative provisions
  - Any statutes expressly governing?
  - Other powers of the trustee expressly granted or implied?
  - State law governing? Has the governing state adopted Uniform Acts? Can/should the trust's governing state law be changed to a different state?
  - Decanting ability or other trust modification ability, as provided in the trust, and/or by the governing state law?
  - What does the grantor authorize as relates to investing? Does such authorization amount to an instruction, requirement, recommendation or none of the above?
  - Other fiduciaries who need to be included in investment decision-making? Or receive updates?

Phase 1: Develop the plan (IPS)
Assess…

- Beneficiaries
  - What do we know of current, future/remainder beneficiaries?
  - Ages? DOB/DOD? Spouses, issue? Location, citizenship, residency?
  - Financial situation? Earning ability? Other assets? Beneficiary of other trusts? Financial sophistication?

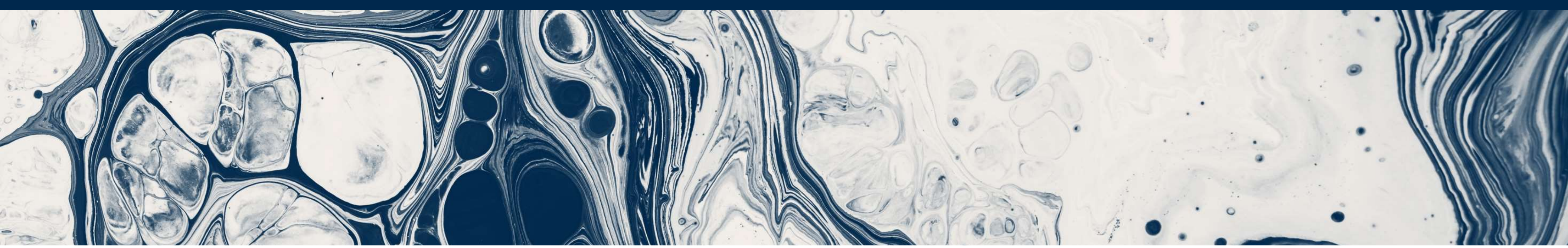
Tax consequences

- Grantor or non-grantor trust?
- State location and tax brackets of trust, beneficiaries
- GST exempt or non-exempt?
- Estate tax includible?
- Tax basis of trust assets? Taxable or tax-free income?

Phase 1: Develop an investment strategy using all the inputs

- Income
  - Is there a requirement or desire to produce income? If yes, is it is a priority?
    - Maximize net income?
    - Prioritize producing income that is tax-free to the beneficiary?
    - Produce a unitrust amount of a similar (or growing) amount each year?
- Principal
  - How and when will principal be accessed?
    - Long-time horizon with aggressive growth as main objective?
    - Immediate, near-term or ongoing need, such that preservation of principal is a higher priority?
    - Will principal assets likely be sold before distribution to a beneficiary, or distributed in-kind?
- Does the trust articulate priorities? Timeline? Purpose? How do these inform risk tolerance?
- What is an asset allocation that supports the trust fulfilling its purpose on its timeline?

Phase 2: Implement the plan



Phase 2: Implement the plan (Administrative)
Draft the Investment Policy Statement (IPS)

Articulate how investing trust assets will be addressed, including but not limited to:

Income and principal priorities and goals, and which items were reviewed to determine such priorities and goals (items in Phase 1)

Reasoning for why and how the target asset allocation should achieve the goals for income and principal

Why and how certain investment manager(s) have been chosen to manage to the target asset allocation

Plan for how, when and why to regularly rebalance to target asset allocation

Plan for how often to review the target allocation, the portfolio and the investment managers. What criteria will be used?

Schedule/plan for achieving particular goals in the portfolio, such as reaching the target asset allocation, divesting from particular assets, or sticking to a capital gains budget

Phase 2: Implement the plan (Administrative)
Draft the Investment Policy Statement (IPS)

Articulate how investing trust assets will be addressed, including but not limited to:

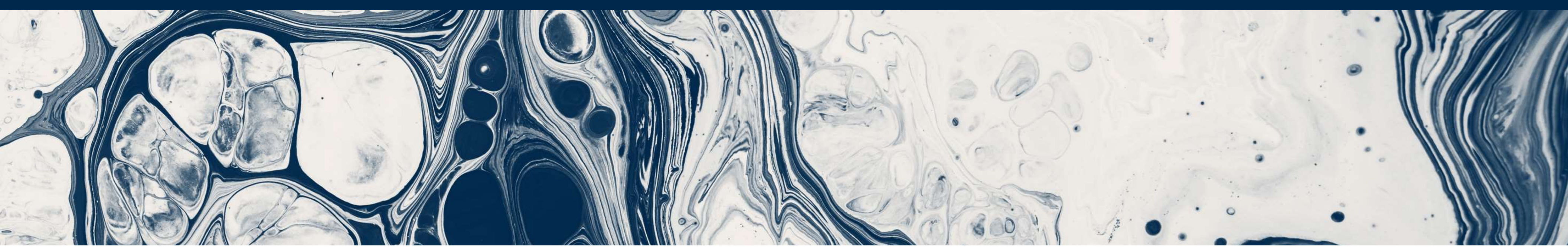
Specific tasks

- Are there specific one-time tasks that need to be accomplished asap, or at a particular point in time
    - Example: sell out of a concentrated asset
- Are there ongoing tasks that need to be accomplished on a set cadence?
    - Example: valuations of real property or review of life insurance policy

Communication

- Who all needs to receive the initial plan?
    - Co-trustees? Other fiduciaries or advisors? Beneficiaries?
    - How will the initial plan be delivered?
- Who all needs to receive updates to the plan (or an update to say the plan is not changing), and an explanation of the change or lack of change? How often?

Phase 3: Monitor the plan



In Phase 3, monitoring the plan can be boiled down to:

As trustee, are you doing what you said you would do in the IPS, and if so, are you documenting what you are doing?

What are the results of doing what you said you would do… should you continue doing it or adjust the plan? Either way, document the reasons for the decision.

Phase 3: Monitor the plan (Fiduciary)
Examples of investment-related items to regularly monitor

- Meet with investment managers on a cadence outlined in the IPS.
  - Document each meeting, items discussed and any decisions made.

- Maintain the schedule and document the completion of tasks as identified in the IPS (such as divesting out of concentrated assets, buying or selling at certain price points, investing cash on a schedule, valuing an asset on a schedule, hewing to a target asset allocation on a capital gains budget, etc.)

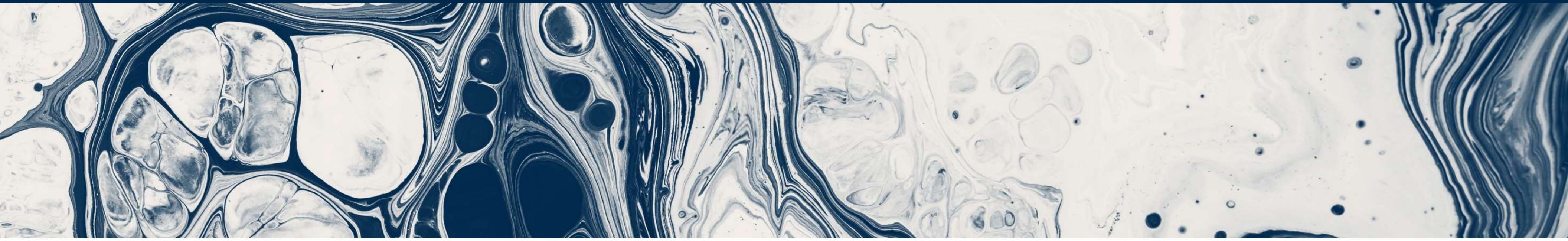
- Review the target asset allocation on a regular basis (annually is typical, and often required) to confirm whether it is still appropriate or needs adjusting.
  - Adjustments might arise with change in beneficiary needs, changes in trust assets, change from one phase of the trust to another (perhaps following a beneficiary death).

Phase 3: Monitor the plan (Fiduciary)
Examples of investment-adjacent items to regularly monitor

- How to monitor investment managers?
  - Establish criteria
  - If trust employs multiple investment managers, what is the trustee's plan for monitoring the holistic picture of the trust's investments and understanding the overall asset allocation?
    - Employ a consultant?
    - Trustee monitors the entire picture?
    - Consider consolidating managers?

- How to monitor tax impacts?
  - Have tax impacts been as expected for the trust, grantor, beneficiaries?
  - Any tax-related changes coming? (For example, grantor trust status, trust situs move, beneficiary move, death of beneficiary, sale of major trust asset, change to tax law)

Examples of specific trust situations



After considering an organized way to approach a trust's investment plan, what are some "real life" issues that often play out in these scenarios?

Examples
Grantor vs non-grantor trust

Common considerations

- Grantor's concern over personal income tax impacts
- Will asset substitution likely happen in the future? How does this impact investment decisions now?
- Is toggling off grantor-trust status likely in the future? How does this impact investment decisions now?

Common pitfalls

- Grantor requests investments that consider personal tax impact to grantor
- Grantor is tired of paying income taxes, but may want to preserve substitution power
- Grantor is resident in a high-tax state, wonders if it still makes sense to personally pay income tax
- Grantor doesn't have liquidity to pay income taxes as trust grows larger

Examples
Directed trust

Common considerations

- Does the state allow for directed trusts?
- Does the grantor want a party other than the trustee (who may have been selected primarily for situs reasons) to control the investments?
- Does the trustee want to be absolved of responsibility for continuing to hold a concentrated asset, an asset in which the trustee has no expertise, etc.

Common pitfalls

- Parties assume that because the investments are directed, the trustee won't need to have any involvement with the trust investments
- Generally, a directed trustee still needs certain information on the trust assets on a regular basis for the purpose of inventorying, valuing, recordkeeping, other due diligence
- The trustee may need to be able to custody a directed asset

Examples
Split-interest trust (e.g. Marital, Charitable Remainder)

Common considerations

- If the trust will distribute net income, how to approach investment decisions on producing income versus growth?
- Is producing tax-free income a priority? What if it means producing less overall income and/or growth?
- If the trust is a unitrust, how to think about investing for total return?
- Consider converting to a unitrust?

Common pitfalls

- Classes of beneficiaries have conflicting interests as to income versus long-term growth
- Classes of beneficiaries have conflicting timelines/priorities

Examples
Trust assets that are includible for estate, generation-skipping (GST), and/or state income tax purposes

Common considerations

- Understand ahead which assets will likely be subject to estate and/or GST tax, at date of distribution and/or date of death of certain individuals
- Which trust assets might receive a step-up in basis and which will not?
- In which states do parties or trust assets reside? What are state income tax impacts?
- How do these tax impacts inform trust investment decisions?

Common pitfalls

- Different classes of beneficiaries and other parties (such as the grantor) will be affected by tax impacts differently

Examples
Irrevocable life insurance trusts (ILITs)

Common considerations

- Understand the policy type and structure
- Understand the need that the policy is intended to solve (Estate tax? Business succession?) and asses whether it is the right policy to meet that need
- Understand how premiums will be paid, and the accompanying investment needs. Annual cash gifts? A one-time endowment gift to the trust?

Common pitfalls

- Policy is underperforming
- Trustee does not have life insurance expertise and does not consult experts
- The need that the policy was intended to solve has changed (or the grantor's view of the need has changed)
- Grantor doesn't have liquidity to make gifts to pay premiums, or doesn't want to

Examples
Trusts with concentrated assets – real estate

Common considerations

- Understand the plan … sell real estate promptly to diversify trust assets, or hold the real estate long-term and generate income for the trust?
- Does the trustee have expertise to manage the real estate? Should a manager be considered?
- Might the property be occupied by a trust beneficiary?
- Should the trustee be directed?

Common pitfalls

- Parties have emotional attachment to property
- Potential liability associated with property
- Property locked in to a long-term lease
- Liquidity needed for upkeep, unexpected expenses
- Effects of climate, water rights, commodity prices

Examples
Trust funded with all cash

Common considerations

- Trustee needs to invest the cash to reach target asset allocation
- Invest all at once, or methodically on an agreed-upon schedule?
- Time in the market
- How much to keep in cash for trust expenses, distributions? Is there a minimum cash balance trust shouldn't fall below?

Common pitfalls

- Parties complain that cash was invested when market was too high
- Parties complain that too much sat in cash for too long
- Parties complain when securities have to be sold later to raise cash, especially for a large distributions … why didn't we keep the cash we had?

Examples
Trusts with concentrated assets – illiquid funds

Common considerations

- In the case of private equity, hedge funds, etc., is this an asset the trustee has expertise to monitor and manage?
- Consider being directed?
- What is the appropriate allocation to this asset within a trust's overall portfolio?
- What if this asset grows in value more quickly than other trust assets, throwing off the target asset allocation?

Common pitfalls

- Takes a long time to see the net result
- Hard to change the investment decision once committed to a fund
- Illiquid investments are not always transparent
- Illiquidity may pose challenges if trust distributions need to be made, or if trust assets need to be valued
- Will there be capital calls or other cash demands? Can the trust support them?

Examples
Trusts with concentrated assets – publicly traded stocks

Common Considerations

- Sell the entire concentrated stock position, or keep some?
- Of the concentrated stock trustee decides to sell, will trustee sell as soon as possible or sell gradually on a set schedule?
- Is the trustee equipped to sell in a way that does not negatively impact the stock price?

Common pitfalls

- Settlor, beneficiaries or trustee have emotional attachment to the stock
- The family is still invested in the stock in other trusts or in personal accounts, or family members still work at the company or sit on its board
- Waiting for the “right time” to sell
- Hesitating to sell because wanting to avoid capital gains

Examples
Low-basis securities that don’t fit target asset allocation

Common considerations

- Sell the non-target securities ASAP and get into the target asset allocation sooner?
- Or shift to target asset allocation over an agreed timeframe that allows for market opportunity, perhaps hewing to a capital gains budget?
- If a grantor trust, are there opportunities to substitute out the low-basis securities?

Common pitfalls

- Grantor or beneficiaries complain about capital gains tax after securities are sold to rebalance. “The securities we had were diversified, they were fine!”
- Temptation to hold securities too long, due to capital gains avoidance, then getting caught in a downward market cycle, at which time there is temptation to hold longer to wait for a better price … there will always be a reason to hold!

Conclusion