Managing Fiduciary Issues In Challenging Times

November 17, 2020

Chicago Estate Planning Council

Anita Sarafa, Adam Clark, Monique Valbuena

J.P.Morgan Private Bank

CEPC

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Welcome and Announcements

Chicago Estate Planning Council

Kim Kamin

CEPC President

New Members Announcement

Chicago Estate Planning Council

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Membership Committee Report

Kathy Garlow

Chair

Upcoming Events

Chicago Estate Planning Council

November 19th
virtual event 4:30 – 5:30
Annual Networking and Charitable Drive

December 3rd
Virtual Monthly Program
Intellectual Property and Estate Planning with
Chang Chae
Hoffman, Sabban & Watenmaker in LA

Speaker Introduction

Julie Pleshivoy
Vice President & Program Committee Chair, CEPC

Speaker

Chicago Estate Planning Council

Anita Sarafa
Midwest Wealth Advisor Team Lead
Managing Director

From her Chicago base Anita oversees a team of Wealth Advisors across the Midwest. She works with clients on their comprehensive estate planning needs and goals, including alternatives for tax-efficiently holding, managing and transferring their wealth to family members and charities. Anita is also a resource on family office formation, family governance issues, next generation education, and family meetings.

Anita speaks and writes nationally on topics related to sophisticated estate planning techniques, multi-state estate planning, charitable giving and tax planning, and has been featured in The New York Times, Dow Jones, Business Week, The Wall Street Journal, Barron's, The Chicago Tribune, CLTV and other local and national media.

Anita is admitted to practice in Illinois as an attorney and a fellow of the prestigious American College of Trust and Estate Counsel (ACTEC). She is past president of the Chicago Estate Planning Council, a 650 member professional organization, a planned giving advisory board member to the Ravinia Festival, a Garden Heritage Society Ambassador for the Chicago Botanic Garden, a member of the Legacy Partners of the Ann & Robert H. Lurie Children's Hospital of Chicago and a member of the WTTW and WFMT Planned Giving Advisory Committee. She is also the past president and treasurer of the Auxiliary Board of Northwestern Memorial Hospital.

Prior to joining J.P. Morgan Private Bank in 2000, Anita was a partner with the Chicago-based law firm of Winston & Strawn and a member of both its Trust and Estates and Corporate Departments. Anita earned her B.A. in Political Science from the University of Michigan and her J. D. from Boston University School of Law. She resides in Glencoe, Illinois, with her family and enjoys spending time at their home in Santa Fe, New Mexico.

Speaker

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Adam Clark

Global Head of Trusts and Estates
Managing Director

Adam Clark is Global Head of Trusts and Estates at J.P. Morgan Private Bank, overseeing approximately $160 billion in assets across the globe. One of the industry's recognized trust and estate professionals, he leads approximately 500 employees who advise and support clients' legacy planning and management.

A leading fiduciary specialist, Mr. Clark has held various leadership positions in the industry. As Chairman, Chief Executive Officer and President of Goldman Sachs Trust Company, he led a team that operated in five jurisdictions and oversaw $24 billion in assets. During his tenure, he also served as Head of International Strategic Wealth Advisory, where he worked directly with the firm's most sophisticated clients. Previously, Mr. Clark spent nearly a decade with WTAS LLC, formerly Arthur Andersen, where he focused on tax planning issues for families with multi-jurisdiction considerations, including multiple citizenships and residencies, as well as global business and investment interests.

A graduate of the University of Liverpool, with a Bachelor of Laws in English and German Law, Mr. Clark lives with his family in New Jersey.

Speaker

Chicago Estate Planning Council

Monique Z. Valbuena
Midwest Team Lead, Trusts
Executive Director

Monique Z. Valbuena is an Executive Director and the Regional Trust Practice Lead for the Midwest with J.P. Morgan Private Bank. Overseeing a team of Trust Officers and Administrators, Monique provides advice and guidance regarding the management and administration of fiduciary accounts. This work includes mitigating and managing risk, litigation case management, investment risk management, and client relationship management with the fiduciary practice.

Prior to joining J.P. Morgan in 2013, Monique practiced trusts and estates law at Gordon, Fournaris & Mammarella, P.A. in Wilmington, Delaware, where she represented institutional fiduciaries and individuals in matters involving Delaware trust law, trust operations, and foundation planning and administration. Prior to her focus on trusts and estates, Monique practiced corporation law, advising private and public clients on complex corporate, tax and securities law matters, at several prominent law firms.

Monique earned her B.A., magna cum laude, from Georgetown University and her J.D., cum laude, from Georgetown University Law Center, where she was an editor of The Tax Lawyer. Monique is a member of the bar of the Delaware Supreme Court and is an active member of the Estates and Trusts Section of the Delaware State Bar Association and the Chicago Estate Planning Council. Monique has presented to various audiences on tax, trusts and estates, and corporation law. She currently resides in Chicago, Illinois with her son and daughter.

MANAGING FIDUCIARY ISSUES IN CHALLENGING TIMES

CHICAGO ESTATE PLANNING COUNCIL

NOVEMBER 17, 2020

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OVERVIEW

- The current economic environment may be the most challenging ever confronted, and trustees and executors face conditions and decisions once unthinkable
  - Many beneficiaries need greater assistance to weather the storm
  - Market volatility and management of trust assets, such as real estate, business interests and loans,can require trustees to be m ore proactive
  - Executors have additional challenges, with courts facing significant delays, the IRS working remotely and often not accessible, and decedents' homes and tangible assets often in "hot spot" states
- Past economic downturns revealed that those negatively impacted by heavy portfolio losses, market volatility, struggling businesses and other challenges often scrutinize the actions and inaction of those managing their assets. The "Great Recession" of 2008, for example, led to significant litigation by beneficiaries seeking redress for actual or perceived wrongs
  - Even conservative and cautious trustees may face challenges executing their fiduciary duties when dealing with real people and their complicated circumstances
- But challenging economic times arising from a global pandemic never before experienced by living generations do not change a trustee's--or executor's--core duty to administer trusts and estates with skill and care, prudently handle investments and communicate their actions

OBJECTIVES

- This presentation will examine some of the extraordinary and difficult issues faced by fiduciaries in these times of economic uncertainty and other challenging circumstances, and offer insights and best practices to guide fiduciaries, not only to limit future criticism and legal challenges, but more importantly to help clients and beneficiaries prevail through difficult times
- Some key fiduciary practices for successfully managing through challenging times:
  - Know the trust instrument(s)
  - Know your core duties and responsibilities as a trustee and/or executor
  - Following consistent processes for administration and decision-making often will lead to a better substantive result and not just liability mitigation
  - Good communication with beneficiaries is absolutely critical
  - Use technology solutions to connect with and service clients
  - Involve all the right people and experts in decision-making
  - Identify when you have entered risky territory
  - Practice good risk management to avoid or at least mitigate future challenges

Good results are the product of a consistent and thoughtful process

DISTRIBUTIONS: MEETING BENEFICIARIES' NEEDS DURING EXTRAORDINARY TIMES

Incorporate fiduciary duties in discretionary decision-making (i.e., duty of impartiality, duty of care)

Things to consider:

- Increasing distributions to help beneficiaries in times of increased need/economic uncertainty
  - No magic formula when trustees have discretion about making distributions to beneficiaries
  - Process and communication are essential. Pay attention to conflicting duties and conflicting interests involved in a particular trust. A process that demonstrates that the trustees evaluated the potential impacts and consequences of a range of decisions on the varied needs and rights of beneficiaries is the surest method to protect the trustees
  - Gather information and documentation to support the requested distributions
  - Is a loan from the trust more appropriate than a distribution
- Reducing debt service by renegotiating loans and mortgages to a lower AFR/interest rate
- Utilizing power to adjust
- Larger distributions to take advantage of potential tax changes (e.g., distributions from non-exempt trusts)
- Larger distributions from charitable trusts to mobilize charitable goals in response to crisis

DISTRIBUTIONS: FACTORS TO CONSIDER WHEN EXERCISING DISCRETION (NOT EXCLUSIVE):

- Who is requesting the funds?
- What is the nature of the request for funds (purpose)?
- What is the standard for exercising discretion over distributions in the trust?
- What documentation is provided? Is it sufficient? Do you want or need more information?
- What amount is requested? (From income? From principal?)
- What assets does the Trust hold? Is there liquidity?
- What are the capital gains consequences? Who is taxed on any gain?
- What effect will the payment have on income?
- Are outside resources of the beneficiary to be considered and, if so, what are they?
- Are there other beneficiaries? What are their interests?
- Is there a co-trustee? What is the opinion of the co-trustee regarding the request, and has he or she approved?
- Is there a direct payment of tuition or medical expenses?
- Is the trust GST protected? If so, is this the best source of funds?
- Is the beneficiary a skip person?
- What is the intent of the settlor, if known?
- What is the size of the request compared to the value of the trust?
- What is the history of past requests and payments?
- Are there any other relevant factors based on the trustee's knowledge of the situation, including factors specific to the beneficiary's location, community and station in life?

DISTRIBUTIONS: BEST PRACTICES FOR DISCRETIONARY DISTRIBUTIONS—ESPECIALLY IN CHALLENGINGTIMES

- Process is key
- Discretionary decision-making process **MUST** be documented
- "Sole discretion" trusts: Where the trustees are given "sole discretion" the general rule is that their determinations as to distributions cannot be upset unless they are unreasonable
    - The exercise of discretion by a trustee with "absolute discretion" to distribute income to wife and descendants who distributed to wife (even though she had sufficient assets) was held not to be an abuse of discretion (<u>In re Ledyard's Estate</u> (N.Y. Sur. Ct.1939))
- Be fair and impartial: A trustee has a duty to deal impartially with all beneficiaries of a trust and to protect each of their interests
    - Rule applies whether interests are simultaneous or successive
    - Cannot favor one beneficiary over another unless trust provides otherwise (i.e., "Trustee may favor my spouse even if it depletes the trust corpus…")

Best Practice for Fiduciaries: Do not turn discretionary decision-making into a mechanical perfunctory decision. Consider the elements and document your reasons for making or withholding a distribution

INCREASED COMMUNICATION WITH BENEFICIARIES DURING CHALLENGING TIMES

- Fiduciary duty to communicate and furnish information. The trustee has the duty to keep beneficiaries informed regarding the trust and its administration
- The trustee should provide the beneficiary with information about the assets of the trust, the asset allocation, and the trust's investment performance
- The trustee should provide each beneficiary with information about the trustee's actions and the administration of the trust which is relevant to the beneficiary's interest
- The trustee should also provide any additional information reasonably requested by the beneficiary
- The trustee also has a duty to provide notice to the beneficiary, co-trustees and successor trustees, pursuant to the terms of the trust

INCREASED COMMUNICATION WITH BENEFICIARIES DURING CHALLENGING TIMES

- Challenging economic times have made more frequent communication with the beneficiaries absolutely essential. Time of increased anxiety and stress
  - Communication is the easiest way to build trust with the beneficiaries. In challenging times, communication through account statements and accountings may not be enough
  - Communication should be clear and concise
  - Trustees must stay objective
  - Increased communication can reduce misunderstandings, help build confidence in the decision-making process and generate good-will, all of which can reduce the likelihood of disputes later. Best practice to maintain records of communications with beneficiaries
- Inability to have in-person meetings with beneficiaries, co-executors or co-trustees
  - Need to rely on zoom or phone conferences
- Best practice to stay in communication with beneficiaries, including the most vulnerable beneficiaries

BEING A HYPER-VIGILANT AND FLEXIBLE TRUSTEE DURING EXTRAORDINARY TIMES: COMMUNICATION

This year has been extraordinary and clients have looked to their fiduciary for help now more then ever. Here is an example of a situation our clients have faced

Being a hyper-vigilant and flexible trustee during extraordinary times

SITUATION	The bank is a directed trustee of a trust where the one powerholder became incapacitated and couldn't give investment directions. As the markets grappled with the impact of COVID-19, the firm attempted to proactively reach out to the powerholder to provide market updates, but didn't hear back. Upon reaching out to family members, the firm learned of the powerholder's incapacity.
FIDUCIARY CONSIDERATIONS	Does the trust contain provisions addressing the powerholder's incapacity? What is the level of the powerholder's incapacity? It is mental or physical or both? When did the powerholder become incapacitated?
HOW DID WE HELP?	**The trustee immediately took action, invoking a succession plan for the powerholder and quickly executed market trades.** This situation highlights the importance of a document's having a clear succession plan. In addition to taking action once we learned about the powerholder's incapacity, we also learned that the successor powerholder was on a yacht and did not have access to a printer to create, or execute, a Letter of Direction. **The trustee assisted the pertinent party(ies) using Acrobat Adobe Pro to sign needed docs.**

DEALING WITH TAX CHALLENGES AND NAVIGATING COURT CLOSURES AND OTHER DISRUPTIONS

- **Global Pandemic brought unprecedented issues**
- **Delays by IRS and State Taxing Authorities**: Long delays in response time by the IRS and state taxing authorities
  - IRS closing letters for estates
  - IRS audits
  - State tax refunds
  - Difficulty getting in contact with IRS or State Taxing Authorities
  - Result: These delays have a major impact on trust and estate administration, for example the ability to fully fund trusts and make final decisions
- **Court closures:** Closures and now backlogs delayed many estate openings and administration as well as trust actions
  - During the COVID -19 environment, most courts were initially closed with the exception of true emergency applications. Even now, many courts have backlogs
  - Delays in petitioning courts for instructions before making a decision (e.g., ambiguity in trust document). Can't immunize trustee for actions taken in such cases without a court order
  - Court backlogs cause delays in bringing cases which may result in trustees and feuding beneficiaries having to remain in an "unhappy marriage" longer than desired
  - Probate Matters:
    - Although many courts have transferred proceedings to Zoom, it is not unusual to see 5-6 month delays to appoint executors due to backlogs. However, things are improving as the courts all adapt to the new working environment
    - State/County level delays as well. Executor could get a Certificate of Discharge in Illinois in 2 weeks pre-Pandemic. Now takes several months
- **Communication with beneficiaries is critical**. Let beneficiaries know up front of anticipated delays to set realistic and reasonable expectations. For example, estates will likely be open longer
- **Observation:** See importance of clients funding their revocable trusts prior to death to allow of efficient administration

ESTATE ADMINISTRATION CHALLENGES DURING GLOBAL PANDEMIC: THE NEED FOR INNOVATIVE SOLUTIONS AND COMMUNICATION

- **Taking Action on Original Documents:** Obtaining original documents takes a lot of time and coordination (e.g., obtaining original documents from law firm and bank vaults may be much more difficult due to work from home mandates and the need for dual controls)
- **Difficulties Accessing Decedent Residences and Obtaining Appraisals:**
  - Due to states being added to "hot lists" and travel restrictions, many executors cannot visit all properties held in estates
    - Example: Wisconsin was off and then added back to the "hot list", forcing executors to reschedule site visits
  - Inability to visit estate properties will delay the administration of estates (listing properties for sale, handling valuations and distribution of tangibles, etc.). Creates a back-log of properties to visit in the fourth quarter or when it is safe to travel
  - Accessing homes of decedents requires having proper health protocols in place
- **Delays in Collection of Assets in Remote Environment:**
  - <u>Digital Documentation Is Not Always Accepted</u>: Some institutions will not accept a digital medallion stamp and still require a certified copy of the death certificate and letters of office. It takes a lot of coordination to do things an executor would normally be able to do efficiently absent the global pandemic
  - <u>Retitling of vehicles</u>: Estates often have automobiles that need to be transferred, which transfers have been delayed due to closures of the Department of Motor Vehicles
  - <u>Delays in Collection of Tangibles</u>: Executors and trustees may not be able to coordinate collection of tangibles in the work-from-home environment. For example, we have been unable to collect jewelry from a co-executor while office remains closed

LEVERAGING TECHNOLOGY SOLUTIONS TO SERVICE TRUST CLIENTS

Challenging times may require trustees to adopt new technological tools and solutions

DocuSign

In order to continue servicing our clients, we have leveraged DocuSign to, for example, deliver Letters of Direction to our investment and distribution advisors

Virtual Notarization

We took prompt action based on state emergency orders, which allow for virtual notarizations

Digital Signature Alternatives

We have approved the use of certain digital signature alternatives for documents that would otherwise require "wet" signatures

Smart Mail Solutions

Mail sent to the office is being opened, scanned, and emailed to the recipient by a central team

Artificial Intelligence

Using artificial intelligence to review documents to identify specific trust provisions

HYPERVIGILANCE AROUND CYBER RISKS

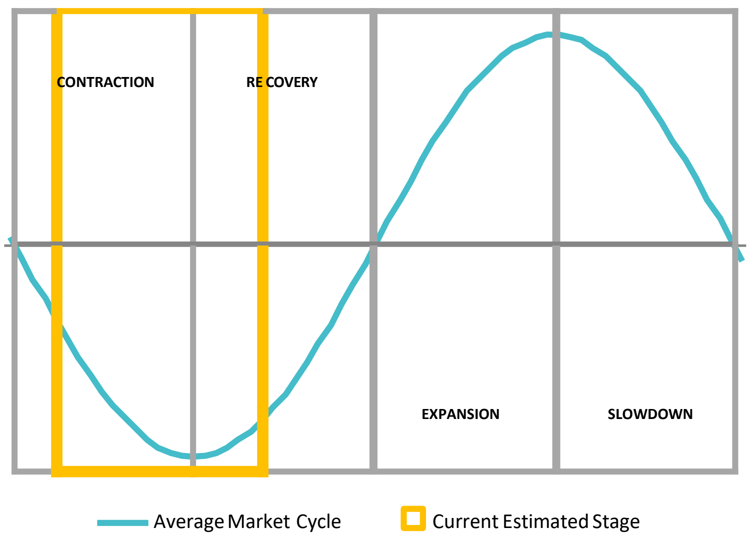
- Increase in sophisticated cyber-attacks/crimes during times of turmoil
- Need for fiduciaries to have strong process for verifying identity of beneficiaries and around distributions
  - Dual controls
  - Verification of identity (e.g. enhanced callback procedures)
  - Use of technology (e.g., voice recognition)

Fiduciaries today face significant challenges managing trust portfolios

ECONOMIC CYCLE

We believe global economic growth will slow in 2020 before rebounding in 2021.

- The economic shutdown in response to the spread of COVID-19 has hampered near-term growth and increased risk across financial markets**. We believe growth will resume in the medium-term but downside risks remain *in the short-run***.
- However, we believe any virus-related slowdown will ultimately lead to higher growth rates once the virus is more under control. **Our base case is that equities have upside in 12+ months.**



KEY AREAS OF FOCUS

Virus-related disruption will negatively impact 2020 growth and earnings:

- We came into the year expecting mid-single digit earnings growth in the U.S. in 2020. Given the disruption to consumption and supply chains globally, there will be an inevitable impact on growth this year, and therefore, **we have materially lowered our earnings expectations for 2020**.
- Unemployment reached its highest level since the Great Depression and will take time to fully recover. **We do not believe earnings and economic activity will return to 2019 levels until 2022.**

Rates are low, but high-quality fixed income remains a key protection asset:

- **The Fed cut rates three times in 2019 and made two emergency cuts in March, moving the Fed Funds rate towards 0%.** This monetary easing and other aggressive actions by the Fed coupled with strong fiscal support should help soften the blow of the virus-related slowdown but is unlikely to completely reverse it.
- **Core Bonds have helped protect portfolios so far in 2020**. This allocation continues to serve as a **key buffer against equity risk**. We have also added tactically to **high yield corporate bonds** in recent months as we believe the asset class currently offers a more attractive risk/reward than equities.

Despite short-term caution, medium-term upside exists across risk assets:

- **In the short-term, we believe markets will continue to be volatile,** especially as we head towards the U.S. Presidential Election**.** We reduced equity targets in March and added to fixed income and cash.
- **However, we believe equity markets will be up in 12-18 months**, assuming that the pace of new COVID-19 cases continues to decelerate. **We added back incremental risk in April and May through high yield corporates and equities.**

Source: J.P. Morgan as of 8/31/2020. The views and strategies described herein may not be suitable to all investors, and more complete information is available which discusses the risks, liquidity and other matters of interest. Please contact your J.P. Morgan representative. **Past performance is no guarantee of future results.** It is not possible to invest directly in an index.

INVESTMENT RELATED RISKS FACING FIDUCIARIES TODAY

- Balancing current income beneficiaries' needs against those of remainder beneficiaries
- Ability to diversify exposure
- Understanding of asset class
- Oversight of non-approved investments
- Concentration risks
- Proprietary investments
- Acting in a prudent manner
- Accredited Investor/Qualified Purchaser (AI/QP)
- Income needs and liquidity events
- Correlation between asset classes, managers, and other factors
- Power to adjust
- Risk/reward tradeoffs (systematic risk, unsystematic risk, volatility)
- Inclusion of alternative strategies
- Self-dealing issues
- Manager selection and on-going monitoring
- Oversight of non-approved investments
- Delegation of investment authority
- Use of derivatives to hedge or mitigate losses
- Tax issues: UBIT impact; State Sourced Income; Charitable Excise Tax/IRC 4944 & Private Foundations/ IRC 4941

TRUST INVESTING IN CHALLENGING ECONOMIC TIMES

- **Fiduciary duties around investing long-term trusts remain despite turbulent markets (e.g., duty to diversify, duty of loyalty)**
  - Follow a prudent investment process and document it, showing standards of care used to safeguard assets
  - Prudent Investor Act requires trustees to diversify trust assets, unless otherwise directed by the trust agreement or if the trustee reasonably determines that doing so runs contrary to the beneficiaries' interests
  - Follow the terms of the governing document
- **Fiduciaries need to thoroughly evaluate the financial risks to the portfolio and needs of the beneficiaries**
  - Scrutinize trust investments for performance, diversification and projected income as well as short-term and long-term growth
  - Reassess investment strategy and asset allocation, considering the balance of higher risk and more defensive assets
  - Obtain updated near- and long-term income and growth projections of the trust assets, using the best available assumptions
  - Evaluate cash and liquidity needs; beneficiaries and trust-held businesses may have different needs during challenging economic times
  - Tax-loss harvesting and asset rebalancing should be discussed, depending on each trust's circumstances
  - Review special items such as loans, e.g., consider liquidity for loans made or due, whether with financial institutions or beneficiaries
  - Review up-to-date financial information for any illiquid assets held in trust and consider any actions that may need to be taken
- **Impact of potential tax changes, e.g., potential for much higher capital gains rate and potential loss of step up**
- **Consider new opportunities to invest in attractively priced investments**
- **Keep clear and detailed records of decisions, including advice received from beneficiaries, advisors and third parties**

HOW TRUSTEES HAVE HELPED ESTATE AND TRUST CLIENTS WEATHER THIS STORM: TRUST ASSETS

This year has been extraordinary and clients have looked to their fiduciary for help now more than ever. Here is an example of a situation our clients have faced

Helping our clients reduce debt service burden on their trusts

SITUATION	There are many trusts of which a firm is serving as corporate trustee, in some capacity, where the trust has debt payable to a third party. In many cases, the debt is to the grantor of the trust
FIDUCIARY CONSIDERATIONS	Is refinancing the debt in the best interests of the trust and the beneficiaries? Who is the lender? Does the lender rely on the note payments for an income stream?
HOW DID WE HELP?	With the AFRs at historic lows, we initiated conversations with the lenders about re-financing the loans to reduce the debt service burden on those trusts. After compiling a list of all loans in trusts, including information on principal balances stated interest rates, maturity dates, etc., we contacted lenders, who often were willing to modify loan agreements. In one example, we helped a trust save over $12MM in annual interest payments through refinancing! **We were thus able to help increase the value of trusts in an environment in which asset values had generally declined**

Who are you investing for? Discretionary trusts are different

Investing for a trust as a discretionary trustee with investment authority is different than investing for an individual with a typical investment management account.

	Fiduciary Responsibility	What Fiduciaries Should Know
1 Intent of the Grantor	Understand the trust type, terms of the trust and any restrictions to ensure the trust operates as explicitly intended by the grantor relative to the needs of the beneficiaries.	Trustees will review the trust instrument and understand the terms and any investment restrictions.
2 Current (Income) Beneficiaries	Generate income to meet the needs of beneficiaries today (e.g., grantor's children) to the extent reasonable.	Understand current income beneficiary needs through meetings and other communications with the beneficiary.
Competing Objectives? The objectives of Current and Remainder Beneficiaries may be in competition.		
3 Remainder (Principal) Beneficiaries	Preserve and grow the principal for future beneficiaries (e.g., grantor's grandchildren).	Remainder beneficiaries must be considered in the investment strategy throughout the lifetime of the trust. The trustee owes remainder beneficiaries a duty to responsibly grow trust assets over time.
4 Tax Impact	Determine the income tax opportunities/ consequences based on the terms of the trust, beneficiaries, and investment approach.	Understand who is paying capital gains taxes and whether changes to the portfolio will affect beneficiaries.
5 Frequency/ Size of Payouts	Understand the plan for distributions over the lifetime of the trust.	Investment decisions should factor in the distributions. Distribution amounts and frequency could impact liquidity and taxes.

Sample scenarios & considerations for selecting an appropriate investment portfolio

	$5MM Revocable Trust	$10MM Irrevocable Trust (Non-grantor)	$100MM Private Foundation
1 Intent of the Grantor	The assets in the trust are administered in the same manner as the grantor's non-trust assets for tax and non-tax reasons.	Trust assets support grantor's surviving spouse. Remainder distributes outright to grantor's daughter at spouse's death.	Private Foundation governing document names five charities to donate to in perpetuity.
2 Current Beneficiaries	Grantor is the sole current beneficiary while alive and competent.	Spouse depends on trust for living expenses (e.g., rent, lifestyle).	Charities receive income generated by trust or required minimum distribution amount (higher of the two).
Competing Objectives? The objectives of Current and Remainder Beneficiaries are likely in competition.			
3 Remainder Beneficiaries	After the grantor passes away, beneficiaries are the grantor's spouse and children.	Daughter will receive the assets when the trust terminates.	Investor preserves and grows principal for the benefit of the charities.
4 Tax Impact	Grantor pays all income taxes associated with trust. As trust assets are included in the taxable estate of the grantor, cost basis will step up at grantor's death.	Capital gains are taxed to the trust. Spouse is taxed on income distributions received.	Use an offshore vehicle to block UBTI risk if investing in hedge funds or other assets that may produce UBTI.
5 Frequency/ Size of Payouts	Grantor may request income or principal distributions from the trust at any time.	Trust pays income (interest, dividends) monthly to spouse.	Foundation pays out minimum distribution amount of $5MM (5% of FMV) annually.
★ Investment Portfolios to Consider	Conservative, balanced or growth portfolios may be appropriate depending on the needs of the grantor, similar to any personal account.	A balanced portfolio may be appropriate given the need to provide for both current and remainder beneficiaries.	A balanced or growth portfolio may be appropriate given the long time horizon. Need to be cognizant of liquidity constraints.

OVERVIEW OF PRUDENT INVESTMENT PROCESS

- Identify and take into account the specific investment powers in the trust and note any directions or restrictions (i.e., ability to retain asset x; no speculative investments)
- Within the parameters of the Prudent Investor Rule, adopt an investment policy for the trust that complies with the directions given and the needs of the beneficiaries and facilitates meeting of the trust's objectives
- Establish a sophisticated investment process that ensures that accounts are diversified and risk return objectives are established
- Maintain an investment balance designed to meet the current liquidity needs of the income beneficiaries while producing risk-adjusted future growth for the remainder
- Maintain complete, accurate and detailed record of all income and expenses of all purchases, sales and other transactions of the trust
- Scrupulously avoid any act of self-dealing or conflict of interest
- Exercise a high degree of diligence and care in carrying out the terms of the trust, making investment decisions and in keeping the funds skillfully invested
- Establish formal guidelines for investment managers and maintain close supervision
- Maintain proper and adequate insurance on trust assets, as needed
- Manage cash including sweep functions
- Determine which assets require special skills to manage

PRUDENT INVESTOR RULE

The Uniform Prudent Investor Act –A uniform statute that sets out guidelines for trustees to follow when investing trust assets. It updated the Prudent Man Rule:

- A trustee's investment management is evaluated in light of the portfolio as a whole, rather than individual investments
- Invest trust assets in light of the portfolio as a whole
- Trustees must consider overall risk and return objectives
- Trustees may consider any type of property or investment as part of the overall portfolio even though the investment might be imprudent standing alone
- Diversification is the rule unless, under the circumstances, it is not prudent not to do so
- Act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents
- Trustees have the duty to continue to monitor the suitability of existing and new investments and oversee managers
- May only incur costs that are appropriate and reasonable in relation to the investment responsibilities

DIVERSIFICATION AND CONCENTRATIONS

- Under The Uniform Prudent Investor Act, a trustee shall diversify the Investments in the trust unless the trustee reasonably determines that, because of special circumstances, the purpose of the trust are better served without diversifying
  - Diversification minimizes the uncompensated risk of having too few investments
  - Challenges arising for trustees: 1) grantor and beneficiaries do not want to diversify; 2) concentrations usually exist for a reason (historical, emotional, judgment calls, restrictions, control blocks) and 3) nobody agrees on exactly when or how to diversify
  - What is diversification? Asset class level? Security/Manager level?
  - Heartstring assets – The Prudent Investor Act says that the wish to retain a family business is a situation in which the purposes of the trust sometimes override the conventional duty to diversify. How do you balance this with diversification?
  - Tax consequences – duty to diversify but the tax costs of selling a block of low basis securities may outweigh the advantages of diversifying
  - Dual needs/impartiality to multiple beneficiaries
- Need to continually educate beneficiaries regarding diversification
  - Importance of performance reporting/communication to co-trustees and/or beneficiaries
- Concentrations
  - How is a concentration defined? 10% of trust market value? 20%? More?
  - When appropriate, consider using derivatives to hedge concentrations
- The Uniform Prudent Investor Act elevated diversification to a "duty" instead of a policy. This has been a huge contributor to fiduciary litigation regarding concentrated investments (The <u>Lilly</u> CRATS, <u>Wood</u>, <u>DuMont Americans' for the Arts</u>).

MANAGING SPECIALTY ASSETS THROUGH ECONOMIC TURMOIL

- Specialty assets held in trusts and estates, including closely-held business interests, real estate, farms and ranches, and oil, gas and mineral interests, require active management and specialized skills
  - Analyze financial and operating results of closely-held assets, in order to benchmark performance, react to material business change, and make fully informed decisions as a shareholder or partner that are in the best interests of the beneficiaries
  - Provide transactional guidance on illiquid assets, working with advisors on pre-and post-liquidity strategies and tax planning
  - Monitor dividend receipts and corporate actions for stock held in each account
  - Vote proxies on behalf of the trustees if requested
  - Assist with buying, selling, managing or transferring real estate, as well as oversee construction, land development, marketing and leasing activities
  - Provide hands-on supervision of livestock production, crop and timber production and wildlife management, using production practices based on a detailed resource analysis
  - Manage oil, gas and mineral interests, including working, royalty and non-producing assets, as well as negotiate and grant leases
  - In challenging times, fiduciaries need to have a thoughtful investment process for closely held-assets, real estate, farms, ranches, oil and gas etc. or hire managers with specialized skills
- Fiduciaries may face unique issues during periods of economic turmoil
  - Directed versus discretionary trusts and responsibilities as executor
  - Applying for government assistance, such as PPP loans and other programs available for small businesses
  - Holding commercial real estate, through challenging times. What if tenants of commercial property cannot make the expected rent payments?
  - Oil and gas or mineral assets may lose value or income stream

HOW TRUSTEES HAVE HELPED ESTATE AND TRUST CLIENTS WEATHER THIS STORM: SPECIALTY ASSETS

This year has been extraordinary and clients have looked to their fiduciary for help now more then ever. Here is an example of a situation our clients have faced

Helping our clients explore government assistance for their small businesses

SITUATION	Bank is co-executor of an estate that owns 100% of a small family-owned operating business. With the significant economic downturn experienced as a result of COVID-19, the business was facing increased financial pressures
FIDUCIARY CONSIDERATIONS	Does the estate have sufficient liquidity to maintain the business? Does the Will require that the business continue, and do the beneficiaries wish to continue with the business? Are extraordinary distributions on behalf of the business consistent with the intent of the Will and governing documents?
HOW DID WE HELP?	A team of specialists with years of experience managing closely held assets assessed overall liquidity needs of the business and whether or not it would qualify for any government assistance. **The team then worked with the co-executor to evaluate the business' needs for the loan and applied for assistance via the Paycheck Protection Program (PPP), successfully obtaining a $2 million loan to help maintain payroll for a staff of approximately 50 employees**

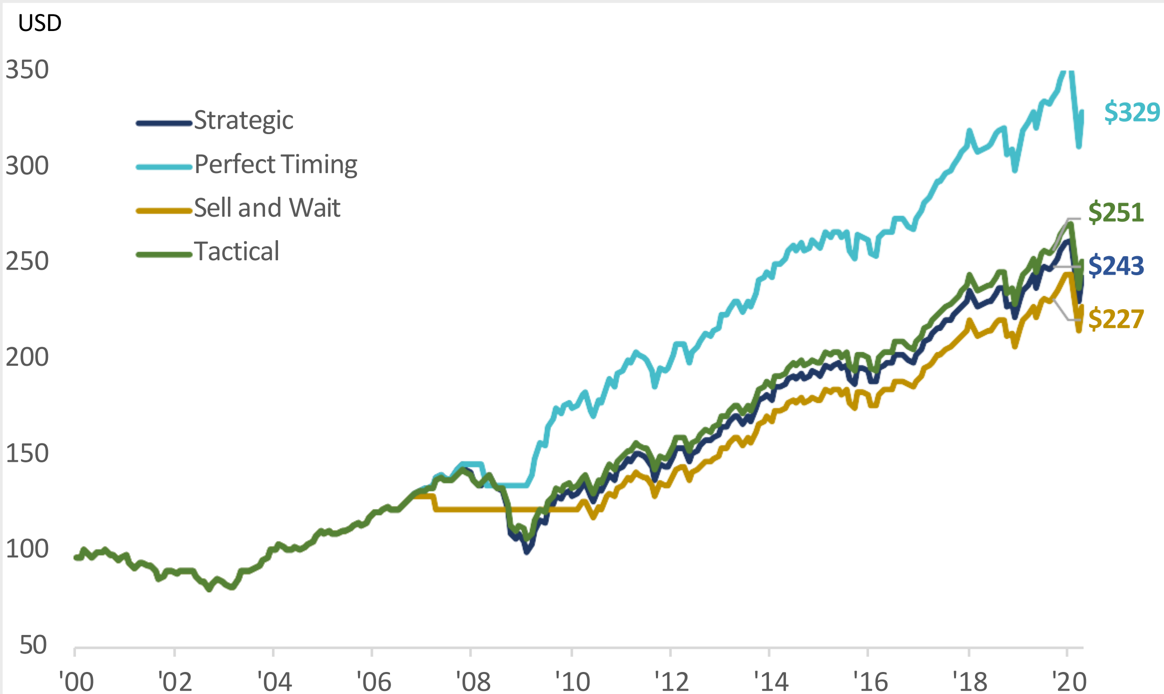
COMMON INVESTING CONCERNS RELEVANT IN CHALLENGING ECONOMIC TIMES

Cashing out	"Why shouldn't I just move everything to cash until markets calm down?" "Why shouldn't I keep my cash positions to ride out the markets" "Shouldn't we hold cash to be able to take advantage of buying opportunities when the market is down?"
Asset allocation	"What mix of asset classes will best help me manage volatile markets?" "Shouldn't I go back to the basics of stocks and bonds?" "With a market pullback, isn't this a good time to buy more stocks?" "With the market so volatile, shouldn't I be more conservative?"
Due diligence	"How do I make sure that I am choosing the right managers?" "What monitoring should I do for my money managers"
Payouts	"Should I change the payouts of my trusts in response to changing markets? Am I threatening the long-term survival of the trust by trying to preserve my beneficiary's current lifestyle?"

"WE'VE HAD A GREAT RUN – LET'S TAKE CHIPS OFF THE TABLE AND WAIT TO GET BACK IN."

"What if we sell out ahead of the next recessions, let the coast clear, and then get back in?"

GROWTH OF $100 INVESTED 12/31/1999 IN A BALANCED ALLOCATION



Scenario 1, Strategic: Own a Balanced allocation and simply rebalance quarterly, making no other changes.

Scenario 2, Perfect Timing: Exit the Balanced allocation ***at the peak*** of markets ahead of the Global Financial Crisis AND re-enter the Balanced allocation ***at the trough*** of market during the Crisis.

Scenario 3, Sell and Wait: Own a Balanced allocation, and ***12 months before the peak*** in equity markets, exit the portfolio and move to cash. And then ***12 months after the trough***, move back to the original Balanced allocation.

Scenario 4, Tactical: Own a Balanced allocation, and ***12 months before the peak*** in equity markets, we sell 10% out of equities and move it to bonds (resulting in a 45% Stock / 55% Bond portfolio). And then ***12 months after the trough***, we move back to the original Balanced allocation.

TAKEAWAYS

Timing is tough. **Even through the Global Financial Crisis, an investor with *good timing* still would've been better off staying fully invested.**

Tactical adjustments can help "weather the storm" and have the added benefit of maintaining exposure to markets to capture the eventual bounce-back.

For illustrative purposes only. Source: Bloomberg as of 4/30/2020. Indices used are MSCI World and Barclays 1-17 Muni Index. Assumes investor paid long-term capital gains tax at a rate of 23.8% upon sale of their stock/bond portfolio. For illustrative purposes only. This information does not reflect the performance of any specific investment scenario.

BUT WE'VE ALREADY MADE BACK 75% OF THE DRAWDOWN IN THE S&P 500!

Historically, a retracement of this much from lows does not mean markets can't keep going

30%+ drawdown event	Bottom	Days ←→	75% Retracement date	S&P 500 Returns over next….		
				60 days	1 year	3 years
Recession of 1969-70	5/26/70	218	12/30/70	8.8%	11.6%	21.7%
Oil Crisis / 1973-75 Recession	10/3/74	463	1/9/76	9.1%	14.9%	21.7%
Black Monday	10/19/87	466	1/27/89	5.8%	20.5%	43.6%
Tech Bubble	10/9/02	1023	7/28/05	-2.9%	2.3%	16.0%
Global Financial Crisis	3/9/09	652	12/21/10	4.5%	2.9%	39.4%
Average				**5.1%**	**10.4%**	**28.4%**
COVID-19 / Liquidity Crunch	*3/23/20**	72	6/3/20	5.8%	?	?

*Estimated.

For illustrative purposes only. Source: Bloomberg using daily returns on the S&P 500.

BEING A GOOD FIDUCIARY IS REALLY HARD…

A good fiduciary must

- Be active in management
- Be diligent and skillful
- Consult with co-trustees or co-executors, if any
- Be confidential on all trust and estate matters
- Seek legal and other professional advice as needed
- Be guided by good faith and fair play
- Deal impartially with all beneficiaries and protect each of their interests
- Be alert to all danger signals
- Prevent all wrongdoings
- Supervise persons involved with the trust or estate administration
- Do not be susceptible to undue influence
- Disclose pertinent information to beneficiaries – COMMUNICATE, COMMUNICATE, COMMUNICATE!
- Do not ignore conflicts (between fiduciary and trust/estate, the fiduciary and beneficiary, the fiduciary and third parties involved in the administration, or even between beneficiaries)
- Fairness, disclosure of all facts and obtaining the beneficiaries consent or ratification are the best defenses

KEY TAKEAWAYS

- We continue to be in challenging times and trustees will always have to prepare for and adapt to current and future challenges, all the while managing their fiduciary duties
- Proactive and frequent communication with beneficiaries, and grantors, during volatile times is critical, even when you do NOT have all of the answers
- Need for a consistent and documented process

Question & Answer