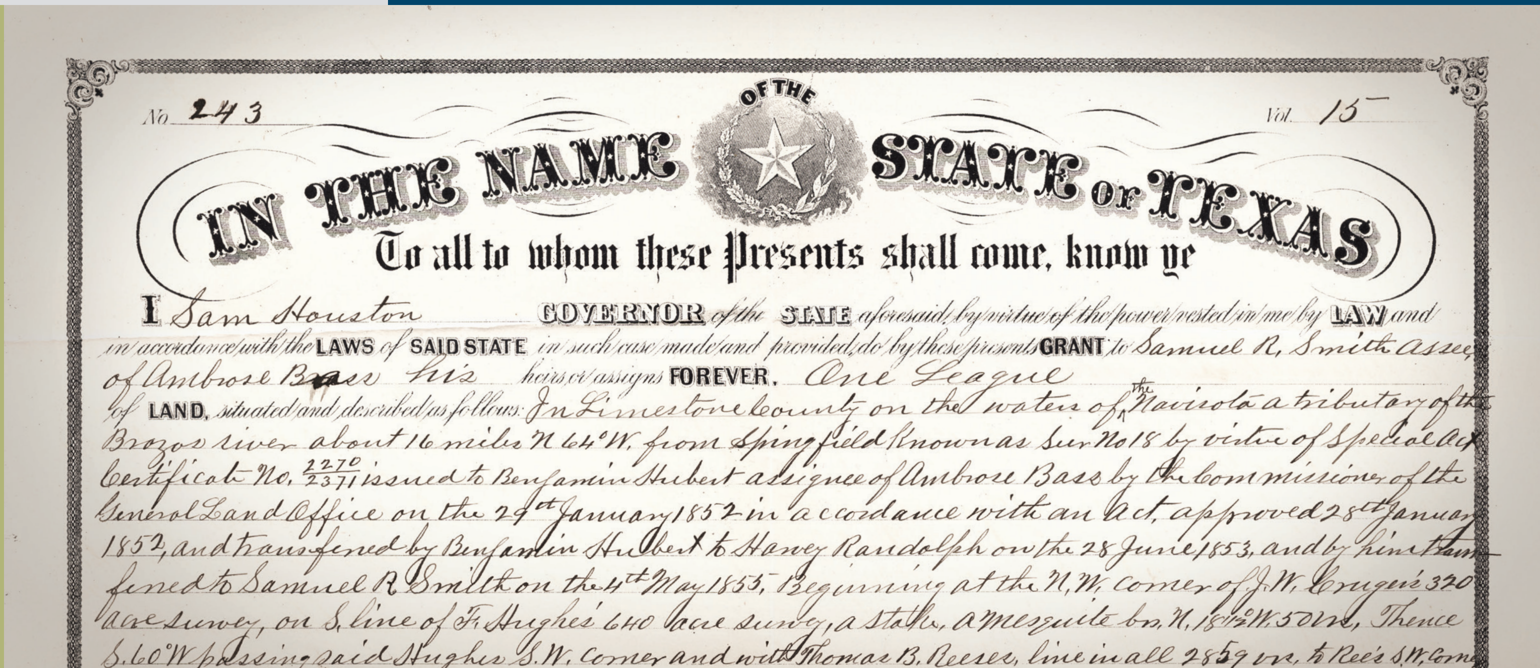
HOUSTON TRUST COMPANY

VIEWPOINTS


No. 243 Vol. 15

IN THE NAME OF THE STATE OF TEXAS

To all to whom these Presents shall come, know ye

I Sam Houston GOVERNOR of the STATE aforesaid, by virtue of the power vested in me by LAW and in accordance with the LAWS of SAID STATE in such case made and provided, do by these presents GRANT to Samuel R. Smith assee of Ambrose Bass his heirs or assigns FOREVER. One League of LAND, situated and described as follows: In Limestone County on the waters of the Navisota a tributary of the Brazos river about 16 miles N 64° W. from Springfield known as Sur No 18 by virtue of Special Act Certificate No. 2270/2371 issued to Benjamin Hubert assignee of Ambrose Bass by the Commissioner of the General Land Office on the 29th January 1852 in accordance with an Act, approved 28th January 1852, and transferred by Benjamin Hubert to Harvey Randolph on the 28 June 1853, and by him transferred to Samuel R Smith on the 4th May 1855, Beginning at the N.W. corner of J.W. Cruger's 320 acre survey, on S. line of F. Hughes' 640 acre survey, a stake, a mesquite brs. N. 18½ W. 50 vrs. Thence S. 60° W passing said Hughes S.W. corner and with Thomas B. Reeses, line in all 2859 vrs. to Ree's S.W. Corner

NOVEMBER 2018, ISSUE 7

Trust Administration

Founded as an independent trust company in 1994, Houston Trust Company has a strong history of fiduciary culture. While Trust Administration does adapt and change to the times, the core tenets of trusteeship remain the same. “The essence of trusteeship is that the trustee shall serve the beneficiary with complete singleness of purpose ... outside interests must be eliminated.”[1] Trusteeship can be, and often is, a long-term proposition, extending down through multiple generations. It entails a careful adherence to governing documents through the prism of statutes, rules, regulations, and common law principles developed over centuries. With this issue of Viewpoints, we attempt to outline the principles of trust administration and the role of the Trustee, or “fiduciary”, who must balance the requirements and rigors of administration with the expectations and needs of the beneficiaries.

The Trust

The term “trust” refers to any type of arrangement whereby a transferor, also referred to as a “grantor”, “settlor”, or “donor”, transfers property to another party, the “trustee”, with the intention that it be administered for the benefit of another, the “beneficiary”. Trusts are created and governed by a written document, usually either a trust agreement (“inter vivos” trust) or the grantor’s will (“testamentary” trust). A well-drafted trust will specify who the beneficiaries are, who may receive distributions, when, and for what purposes, how the trust estate is to be invested and accounted for, various powers and restrictions of the trustee, the line of succession of both the trustee and beneficiaries, the standards of trustee behavior and liability, and other relevant provisions.

Most professionally-drafted trust instruments are very well-written. However, the trustee may occasionally encounter an out-of-date or poorly-drafted instrument, which might contain vague or conflicting provisions. Or, the trust instrument may contain tortuously

Cover image: “Land grant certificate to Samuel R. Smith from Sam Houston as Governor of the State of Texas, 1903 copy of the 1860 original.” (1903) Rice University: http://hdl.handle.net/1911/76229.

[1] Fiduciary Trust Company. (1929). A New Approach to Trust Management [brochure]. Boston, Massachusetts.

complex provisions. If the governing document is silent or unclear as to a particular item, the trustee must refer to applicable legal authorities to determine the proper interpretation of the item in question by consulting statutes, rules, regulations, case law, and/or other interpretive guidance. Sometimes, the trustee must retain legal counsel to get to an answer, both for the trustee's and beneficiary's protection, and in rare cases, the trustee even may have to petition the court for a ruling to provide further guidance. In all of these instances, the trustee must be able to use these tools effectively to discern the grantor's intent, make a good faith effort to comply with that intent, and be prepared to defend the trustee's decisions.

Trust Administration

Trust administration begins with the initial funding of the trust estate. It is the moment the trustee is called into action. This event may occur at the time of creation of an inter vivos trust, but it also often occurs during estate administration. In contrast to estate administration, which typically lasts only a few years, trust administration can be a very long-term prospect and may continue for several generations.

There are two types of trustees—individual trustees and corporate trustees. Individual trustees are often family members or trusted family friends. A corporate trustee is an entity that has "trust powers", meaning it is a corporation authorized to serve as a trustee under the probate and trust codes of a particular state or states. Corporate trustees may serve alone or together with one or more individual trustees. Although most any adult can be appointed to serve as a trustee, special expertise in the proper administration of a trust must be learned or hired. At a minimum, any individual serving as a trustee should possess strong organizational, analytical, and communication skills. Ideally, an individual trustee also should have access to bookkeeping infrastructure, investment, legal, and tax advice, and the ability to devote proper time and resources to the administration. A corporate trustee will have all of the forgoing, as well as capital backing, regulatory oversight, and proper insurance.

Assuming Trusteeship/Fiduciary Duties

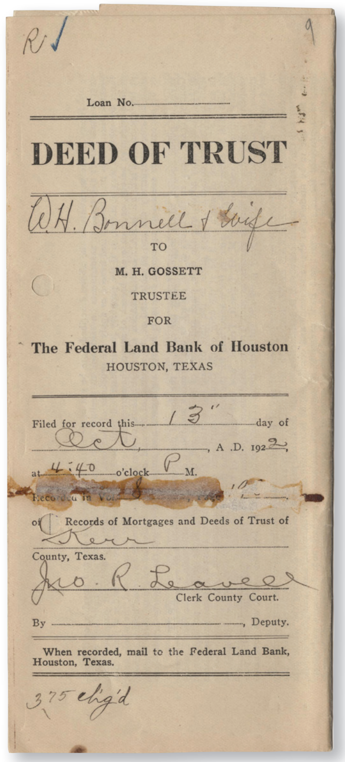
To begin, a prospective trustee should carefully read and fully understand the provisions of the governing document (either the trust instrument or the will creating the trust) before acceptance of the appointment. There are certain duties that must be adhered to by a trustee, which are inherent in the Texas Trust Code, but made clear in case law. Among others, these duties include the duty of loyalty, the duty to retain control of and preserve trust property, and the duty to keep and render accounts. First and foremost, however, is a trustee's duty to administer the trust in good faith according to its terms and applicable law.

To elaborate, a trustee must place beneficiaries' interests before those of the trustee and avoid self-dealing. Although joint investments may be made, the trustee must keep assets held in trust separate from those of the trustee or of others for whom the trustee manages assets. A trustee also must deal impartially with trust beneficiaries.

With regards to trust property, a trustee must take control of all trust property, protect it, and invest it as a prudent investor would. If the trustee possesses special skills, he or she must put those skills to use both in relation to beneficiaries and the trust property. Should any claims be made against a trust, the trustee must defend it, or alternatively, enforce claims should the need arise.

A trustee must keep complete and accurate records of trust activities and should render periodic statements to beneficiaries. It also should be noted that proper trust administration utilizes trust accounting, which is a specialized system of accounting that tracks principal and income somewhat differently from GAAP accounting or Quick Books. The differentiation between principal and income is paramount to trust transactions. For example, the trust instrument may require periodic distribution of "net income"—income received less expenses of the trust. As trust accounting does not always follow financial or income tax accounting rules, some receipts and disbursements may be allocable partly to income and partly to principal. In order to properly calculate the necessary distributions, a trustee must have knowledge of these distinctions and administer the trust accordingly.

A trustee must keep beneficiaries reasonably informed of material facts regarding the trust and should communicate regularly with beneficiaries. The trustee may employ agents and advisors to assist with certain trust functions; however, some functions cannot be delegated, and the trustee must exercise care in the selection and supervision of such agents. In any case, expenses incurred in trust administration must be reasonable.



Loan No.

DEED OF TRUST

W.H. Bonnell & Wife

TO

M. H. GOSSETT

TRUSTEE

FOR

The Federal Land Bank of Houston

HOUSTON, TEXAS

Filed for record this 13" day of Oct, A. D. 1922, at 4:40 o'clock P M.

of Records of Mortgages and Deeds of Trust of Kerr County, Texas.

Jno. R. Leavell Clerk County Court.

By ______, Deputy.

When recorded, mail to the Federal Land Bank, Houston, Texas.

3.75 chg'd

Leavell, John R. [Deed of Trust from W. H. Bonnell to M. H. Gossett], legal document, October 13, 1922; (texashistory.unt.edu/ark:/67531/metapth743569/: accessed October 20, 2018), University of North Texas Libraries, *The Portal to Texas History*, texashistory.unt.edu; crediting Butt-Holdsworth Memorial Library.

Finally, perhaps the most important duty of a trustee is to communicate. A trustee should correspond with beneficiaries regularly and meet with beneficiaries as needed. Doing so will help mitigate the consequences of any misunderstanding.

While a trust's governing document may modify a trustee's fiduciary duties to some extent, a conscientious trustee will follow the common law duties to the best of his or her ability. And while a trustee must be flexible in its thinking to find workable solutions, the trustee should be consistent in the discharge of these duties.

Who Should Serve As Trustee

Turning to the appointment of a trustee, it is common for an individual to name their spouse or one or more of their children—typically the oldest—to serve. Although these arrangements can and do work for some families, we have observed how they also can turn ugly, destroying family relationships and consuming the family's wealth.

Courthouse case records are replete with stories of family fiduciary appointments gone wrong, resulting in diminishment or even total loss of the estate or trust. Sometimes these losses are caused by the family-member fiduciary's inexperience, while outright fraud or theft of estate or trust assets may have occurred in others.

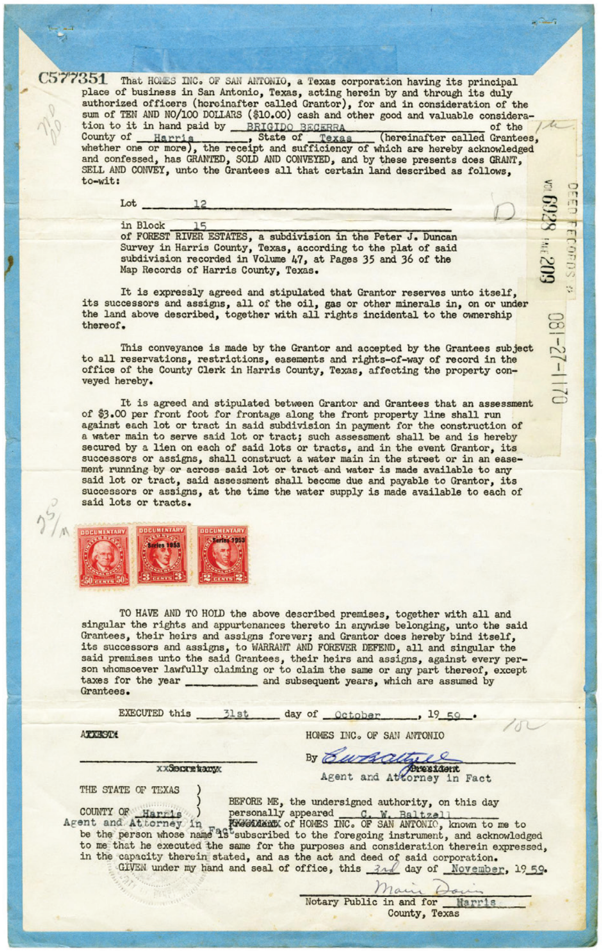
A surviving spouse trustee, though genuinely well-intentioned, may be vulnerable and fall prey to the influences of one or more descendant factions or the wants of an opportunistic new spouse and their progeny. In any case, these individuals frequently do not have prior experience in serving as a trustee and often are not aware of the duties, tasks, and responsibilities required, much less of their own personal liability for breach of trust.

The trust creator may wish to name one or more descendants, typically the children, to serve as trustee for the family. The difficult task of "choosing the right trustee" may be complicated by the fact that children and other descendants will hide intra-family hostilities while the parent trust creator remains alive. However, once this individual has passed, long-simmering rivalries among siblings and other family members can re-surface, causing at minimum intra-family strife, and possibly full-blown feuds.

One way to avoid such an event is the appointment of a corporate trustee. Corporate trustees usually have no immediate ties to the beneficiaries, and therefore, are able to remain impartial and help navigate difficult family relationships. Corporate trustees also are subject to state and federal regulations and are held to a very high standard of care.

Trust Property

A trust estate may be comprised of virtually any type of property. Among the asset types trusts may hold are cash, investment securities, private investment funds, commodities contracts, real estate, mineral and royalty interests, timber and farming/ranching interests, tangible property, rare collections, precious metals, notes and mortgages, and the like. A trustee is responsible for the proper handling and management of everything held in trust. Proper asset allocations and investment plans are necessary and must be governed by the boundaries of the trust instrument (and the law). At the same time, they need to be aligned with the interests of the beneficiaries.



C577351 That HOMES INC. OF SAN ANTONIO, a Texas corporation having its principal place of business in San Antonio, Texas, acting herein by and through its duly authorized officers (hereinafter called Grantor), for and in consideration of the sum of TEN AND NO/100 DOLLARS ($10.00) cash and other good and valuable consideration to it in hand paid by BRIGIDO BECERRA of the County of Harris, State of Texas (hereinafter called Grantees, whether one or more), the receipt and sufficiency of which are hereby acknowledged and confessed, has GRANTED, SOLD AND CONVEYED, and by these presents does GRANT, SELL AND CONVEY, unto the Grantees all that certain land described as follows, to-wit:

Lot 12

in Block 15
of FOREST RIVER ESTATES, a subdivision in the Peter J. Duncan Survey in Harris County, Texas, according to the plat of said subdivision recorded in Volume 47, at Pages 35 and 36 of the Map Records of Harris County, Texas.

It is expressly agreed and stipulated that Grantor reserves unto itself, its successors and assigns, all of the oil, gas or other minerals in, on or under the land above described, together with all rights incidental to the ownership thereof.

This conveyance is made by the Grantor and accepted by the Grantees subject to all reservations, restrictions, easements and rights-of-way of record in the office of the County Clerk in Harris County, Texas, affecting the property conveyed hereby.

It is agreed and stipulated between Grantor and Grantees that an assessment of $3.00 per front foot for frontage along the front property line shall run against each lot or tract in said subdivision in payment for the construction of a water main to serve said lot or tract; such assessment shall be and is hereby secured by a lien on each of said lots or tracts, and in the event Grantor, its successors or assigns, shall construct a water main in the street or in an easement running by or across said lot or tract and water is made available to any said lot or tract, said assessment shall become due and payable to Grantor, its successors or assigns, at the time the water supply is made available to each of said lots or tracts.

DEED RECORDS VOL 6928 PAGE 209

081-27-1170

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TO HAVE AND TO HOLD the above described premises, together with all and singular the rights and appurtenances thereto in anywise belonging, unto the said Grantees, their heirs and assigns forever; and Grantor does hereby bind itself, its successors and assigns, to WARRANT AND FOREVER DEFEND, all and singular the said premises unto the said Grantees, their heirs and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof, except taxes for the year ____ and subsequent years, which are assumed by Grantees.

EXECUTED this 31st day of October, 1959.

ATTEST: HOMES INC. OF SAN ANTONIO

By ____ President
xxSecretary Agent and Attorney in Fact

THE STATE OF TEXAS)
) BEFORE ME, the undersigned authority, on this day
COUNTY OF Harris) personally appeared C. W. Baltzell
Agent and Attorney in Fact President of HOMES INC. OF SAN ANTONIO, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same for the purposes and consideration therein expressed, in the capacity therein stated, and as the act and deed of said corporation.

GIVEN under my hand and seal of office, this 3rd day of November, 1959.

Notary Public in and for Harris County, Texas

Harris County (Tex.) Clerk Office. [Deed for Lot 12, Block 15 of Forest River Estates, October 31, 1959], legal document, October 31, 1959; (texashistory.unt.edu/ark:/67531/metapth249621/m1/1/: accessed October 20, 2018), University of North Texas Libraries, *The Portal to Texas History*, texashistory.unt.edu; crediting Houston Metropolitan Research Center at Houston Public Library.

Generally, a Texas trustee is under a duty to comply with the Texas Prudent Investor Act. This act allows the trustee to make a wide range of investments, but also requires diversification of trust assets by default—unless special circumstances exist such that the trust estate would be better off by not diversifying. Two examples of special circumstances include if a trust would suffer an extraordinary tax impact as a result of full diversification of a concentrated holding, or, if a trust held a highly illiquid asset that could not be sold or liquidated without great expense or loss to the trust estate. The inclusion of a non-diversification clause in the trust agreement might offer some comfort, but the extent to which the trustee is protected from failing to diversify can be contested.

The assets and liabilities held by a trust estate figure prominently into its overall investment, risk, and income tax profiles. As such, the trustee must have a working understanding not only of the potential value the assets and liabilities may contribute, but also of their relative risks and tax attributes. In some cases, the individual trustee will possess no specialized understanding or knowledge of these matters. In others, the trustee may have a background in law, tax, investments, or general business. However, rarely is an individual adequately equipped to handle all aspects of a complex portfolio holding multiple asset classes. In such cases, the value proposition for engaging a corporate fiduciary is particularly strong, as the entity's professional staff can provide a broader spectrum of skill sets and experience and also will have quick access to highly-specialized outside expertise when needed.

A trustee may also borrow funds, issue notes, and pledge or mortgage trust-owned property. In doing so, the trustee should carefully consider all of the relevant facts and circumstances. Why is it necessary to borrow? What is the purpose of the loan? What are the terms? Who is the lender?

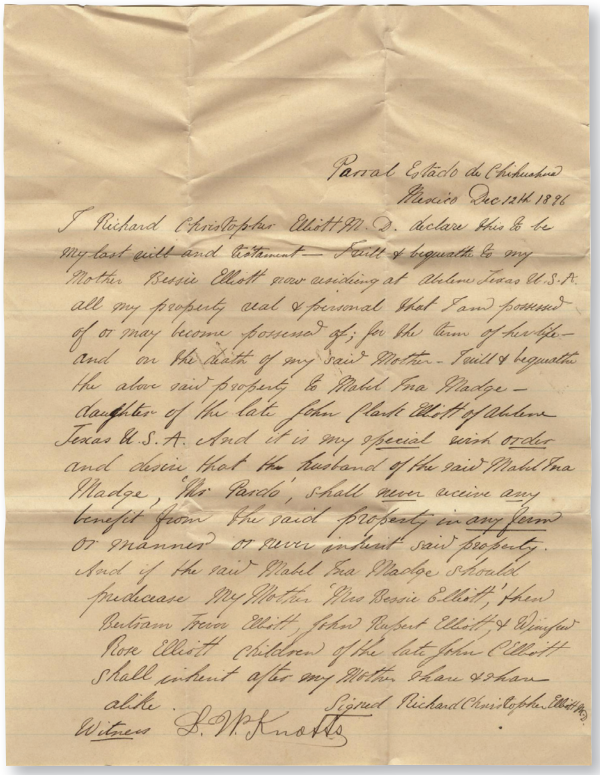
Ultimately, a trustee is responsible for all trust property while it is under administration and must have the resources and wherewithal to manage and protect that property.

Trust Distributions

And now, we come to trust distributions, where everything discussed above comes into play—the trust document, fiduciary duties, income and principal accounting, impartiality, and the proper governance of trust assets. Invariably, a trust's governing document will contain provisions addressing distributions to beneficiaries. It may specify to whom distributions may be made (if at all), how much can (or must) be distributed, when distributions may (or must) be made, and the reasons for which distributions may be made. Depending on the language used in the governing document, this piece of trust administration can be among the simplest—or the most challenging—aspects of the trustee's day-to-day duties.

Standard trust distribution language is often known as "HEMS" whereby a trustee can distribute income and/or principal for a beneficiary's health, education, maintenance and support. This so-called "ascertainable" standard may be further qualified (or limited) by allowing or requiring a trustee to consider the beneficiary's "resources outside of trust" or to take into consideration a beneficiary's "happiness" or "well-being". Requests for distributions to pay college tuition are relatively straightforward and easy to approve. Requests for funds to purchase a car can be more complicated. In general, a car would be necessary for a beneficiary's maintenance and support, but what if the car is a Porsche convertible?

Although many trust instruments contain "standardized" distribution standards, such as "HEMS", or "best interests", or mandatory net income distributions, the drafting possibilities are virtually endless. The one constant, however, is that the trustee is duty-bound to adhere to the standard expressed in the trust instrument. A trustee runs the risk of breaching the trust either by making an unauthorized distribution or failing to make a required distribution. Worse yet, improper distributions could open the integrity of the trust estate to challenge by the beneficiary's creditors.



Parral Estado de Chihuahua
Mexico Dec 12th 1896

I Richard Christopher Elliott M. D. declare this to be my last will and testament — I will & bequeath to my Mother Bessie Elliott now residing at Abilene Texas U.S.A. all my property real & personal that I am possessed of or may become possessed of; for the term of her life — and on the death of my said Mother — I will & bequeath the above said property to Mabel Ina Madge — daughter of the late John Clark Elliott of Abilene Texas U.S.A. And it is my special wish order and desire that the husband of the said Mabel Ina Madge, 'Mr Pardo', shall never receive any benefit from the said property in any form or manner or never inherit said property. And if the said Mabel Ina Madge should predecease My Mother 'Mrs Bessie Elliott,' then Bertram Trevor Elliott, John Rupert Elliott, & Winifred Rose Elliott children of the late John C Elliott shall inherit after my Mother share & share alike.

Signed Richard Christopher Elliott M.D.

Witness S. W. Knotts

Elliot, Richard Christopher. [Last Will and Testament of Richard Christopher Elliot M.D.], text, December 12, 1896; (texashistory.unt.edu/ark:/67531/metapth654876/m1/1/: accessed October 20, 2018), University of North Texas Libraries, *The Portal to Texas History*, texashistory.unt.edu; crediting Hardin-Simmons University Library.

Conclusion

Serving as trustee can be a long-term commitment; one that spans multiple generations. As outlined in this issue of Viewpoints, trusteeship requires careful adherence to the governing document and a comprehensive knowledge and understanding of statues, rules, regulations, and common law principles. A conscientious fiduciary must keep well-informed of these variables in order to navigate the requirements and rigors of administration while managing the expectations and needs of the beneficiaries.

We have observed that individuals often find themselves frustrated by the complexity of the issues presented during trust administration and typically are not in a position to devote the time or expertise required to do the job correctly over a sustained period time. In other cases, mishandling of trust assets can create interpersonal problems and even result in litigation. As such, a corporate fiduciary, whether serving alone, as a co-fiduciary, or as an agent for the appointed individual, can provide the desired objectivity, continuity, and professionalism, to ease the burden of all interested parties. Although the corporate fiduciary must be compensated for its services, such compensation usually results in efficiencies to the trust estate, the long-term benefits of which outweigh the costs.

ABOUT THE AUTHORS

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Mark Herrin joined Houston Trust Company in 2015 after beginning his career in trust and estate administration in 1999. As Senior Vice President of Trust Administration, he specializes in personal trust administration and estate administration. Mark earned a B.S. in Economics from Southern Methodist University, received his Doctor of Jurisprudence degree from South Texas College of Law, and is a member of the Houston Estate and Financial Forum.

Katherine M. Lummis
Vice President, Trust Administration

Kate Lummis joined Houston Trust Company in 2012. As Vice President of Trust Administration, Kate is responsible for personal trust administration as well as overseeing the company's Endowment, Foundation, and Charitable Trust practice. Kate holds a BA, magna cum laude, and an MA from Boston College, and is a graduate of Texas Bankers Association Graduate Trust School and the Rice University CFP Program.

APPENDIX A

A Checklist for Trustees

The following is a basic list of areas of activity for proper execution of the duties of a trustee or co-trustee. While this list aims to identify key considerations for trustees, it is not exhaustive, as trusts often present unique circumstances that require additional actions and expertise in the areas outlined below:

Beneficiary Communication & Relationship Management

- Schedule initial meeting(s) with beneficiary/beneficiaries
- Collect beneficiary information, including:
  - Copy of ID
  - Birthdate
  - Social Security Number
  - Address for reporting and other contact information
  - Family dynamics
  - Relevant financial information
- Engage in beneficiary education
- Maintain periodic contact/conduct meetings with beneficiary/beneficiaries

Administration

- Review trust document to identify:
  - Grantor intent
  - Beneficiaries (current and remainder)
  - Mandatory and/or discretionary distributions
  - Trustee's powers, duties, and liability
- Determine whether Uniform Principal and Income Act governs, if governing instrument alters rules, or if trustee can use discretion
- Perform traditional trust accounting (principal and income) on an ongoing basis and provide periodic statements to beneficiaries
- Retain appropriate agents, including CPAs, attorneys, investment managers, etc.
- Oversee the preparation of trust tax returns and trust tax payments
- Establish procedures for documenting and processing receipts, disbursements, and distributions
- Establish/maintain trust records filing system: legal documents, tax, investments, distributions, correspondence, insurance, etc.
- Conclude administration (termination) of trust by:
  - Partitioning and distributing property
  - Preparing final accounting
  - Obtaining releases from fiduciary duties

Investment Management

- Establish safekeeping and custody of trust assets, including:
  - Stocks
  - Bonds
  - Real Property
  - Life Insurance
  - Personal Property/Collectibles
  - Oil & Gas/Mineral Interests
  - Alternative/Private Investments
- Determine investment objectives for trust estate
- Abide by the Uniform Prudent Investor Act when investing trust assets
- Retain appropriate agents for investment/asset management, such as an investment manager, oil and gas consultant, real property manager, risk management specialist, etc.
- Perform periodic valuation/appraisal procedures