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To: My Friends at the Texas Bankers Association Wealth Management and Trust Division

From: Glenn Karisch

Date: August 1, 2007

Re: Summary of Key Legislative Changes Affecting Texas Corporate Fiduciaries

The Regular Session of the 80th Texas Legislature is over. As usual, there were amendments that affect corporate trustees. Attached is my 2007 Texas Legislative Update, which covers all of the changes in probate, guardianship and trust law. The purpose of this letter is to call your attention to a few changes of particular interest to corporate trustees:

1. Repeal of Statutory Duty to Keep Beneficiaries Informed. Section 113.060 was repealed *effective June 15, 2007*. This is the section that was added in 2005 that caused much consternation and gnashing of teeth among trustees. In general, it hit individual trustees harder than corporate trustees, since corporate trustees usually regularly send trust statements to at least some of the beneficiaries. Nonetheless, it caused corporate trustees to question longstanding practices and generally made everyone very uncomfortable.

The bill repealing Section 113.060 makes it clear that it does not change the underlying common law duty of disclosure. This is an overt attempt to turn back the clock to before January 1, 2006, when whatever duties existed were common law duties. Not everyone agrees on the precise limits of those duties (or even if the duties exist), but everyone seemed to like things better before the enactment of Section 113.060.

Here are some tips for corporate trustees about how to handle Section 113.060 and its repeal:

- Prior to January 1, 2006, many corporate trustees routinely sent trust statements to income beneficiaries but rarely sent them to remainder beneficiaries. Section 113.060 pretty clearly required disclosure to income *and* remainder beneficiaries.

    - *If your organization decided to start sending statements to remainder beneficiaries when Section 113.060 was enacted, then keep sending the notices.* You've already crossed the Rubicon -- whatever effect expanding the list of persons receiving statements has presumably already occurred -- so there is no reason to stop sending statements to remainder beneficiaries.

    - *If your organization did not send statements to remainder beneficiaries after the enactment of Section 113.060, consider making one broad disclosure now.* Sending statements covering the period from the inception of the trust until the present (or, at least, from the commencement of your service as trustee to the present) helps cure any breach of Section 113.060, illustrates that the trustee is trying to comply with the law, and in most cases will start the four-year statute of limitations on breach of fiduciary duty running. The package could include a cover letter explaining that, due to recent changes in Texas law, this information is being sent to you. The safest course of action is to continue to send trust statements to all beneficiaries, including remainder beneficiaries. However, if your organization does not want to do so, then offer each beneficiary the right to continue to receive statements, but require them to request it and agree to keep their address current.

- Include a copy of the trust instrument and other information about the trust and its administration with any post-repeal "make-up" disclosure or once with a routine statement. This information is easy for you to provide, and failure to provide it may be a breach of duty.

- Always make a broad disclosure of so-called material non-standard transactions. Most Texas practitioners agree that, at a minimum, the common law duty to disclose requires the trustee to tell beneficiaries if it is considering a large extraordinary transaction, like selling the family farm or business.

- With all new trusts, adopt a policy of broad disclosure to income and remainder beneficiaries. This is a safer practice and is relatively easy to institute at the beginning of the relationship.

This subject is discussed in more detail beginning on page 10 of my Legislative Update paper.

2. Settlors May Now Permit Self-Dealing by Corporate Trustees. The Texas Trust Code always has prohibited settlors from waiving two statutory self-dealing prohibitions for corporate trustees. The settlor could authorize Uncle John as trustee to engage in self-dealing transactions, but a provision authorizing Big City Bank as trustee to do the same was unenforceable. Over the years, many narrow exceptions were carved out of this general rule (for example, permitting corporate trustees to hold affiliated mutual funds), but the general rule remained.

Now, due to the efforts of TBA's Wealth Management and Trust Division, the rule prohibiting settlors from waiving the self-dealing duty as it applies to corporate trustees has been repealed. Thus, in appropriate cases the settlor may authorize the corporate trustee to own interests in affiliated entities. Also, the settlor may authorize the corporate trustee to acquire insurance for trust property from an affiliated insurance company.

This change should be very useful for corporate trustees who pool trust investments in captive hedge funds or limited partnerships. This is a common technique in other states with very large trusts. Now Texas trustees can use this technique as well.

Note that the statutory duties prohibiting self-dealing are still there. The corporate trustee may self-deal only if the trust instrument specifically authorizes that action (or, put another way, the settlor waives the duty). If you can't find a provision authorizing self-dealing in the trust instrument, then you can't enter into prohibited self-dealing transactions.

The effective date of this change is confusing. I believe the way it will be interpreted is that a corporate trustee may begin to self-deal on or after June 15, 2007, if authorized by the settlor in the trust instrument, but it cannot do so based on the written consent of the beneficiaries until September 1, 2007.

This change is discussed in further detail beginning on page 12 of my Legislative Update paper.

3. Getting Rid of Those Pesky Small Trusts. The Texas Legislature enacted new Section 112.059 of the Texas Trust Code, permitting the trustee to terminate a trust with assets worth less than $50,000. This change was championed by TBA's Wealth Management and Trust Division.

Many trust instruments contain a provision allowing termination of small trusts or trusts which become uneconomical to operate. Now the default Trust Code rule in Texas is that trusts may be so terminated.

The new trust termination provision requires notice to current income beneficiaries and first-tier remainder beneficiaries, but it does not require judicial action. The trustee may terminate the trust if "the trustee concludes after considering the purpose of the trust and the nature of the trust assets that the value of the trust property is insufficient to justify the continued cost of administration."

The statute gives further guidance and imposes a few restrictions. The restrictions will apply to corporate trustees only rarely. This change is effective September 1, 2007.

4. If You Don't Handle 142 Trusts, Skip to #5. For the rest of us, you should be aware that Section 142.005 of the Property Code was *substantially* rewritten. To learn why these changes were made, see page 12 of my Legislative Update paper. Here is what you need to know about the changes:

- **All 142 Trusts Must Have this Warning On Page One of the Trust:**

NOTICE: THE BENEFICIARY AND CERTAIN PERSONS INTERESTED IN THE WELFARE OF THE BENEFICIARY MAY HAVE REMEDIES UNDER SECTION 114.008 OR 142.005, PROPERTY CODE.

- It seems likely that the warning requirement will apply only to new 142 Trusts, but the statute doesn't make that clear. Therefore, consider sending a letter to the beneficiary and to the beneficiary's surrogates mentioning the statutory change requiring the warning and indicating that you do not intend to go to court to ask for the warning to be added to the existing trust unless the beneficiary or his or her surrogates request such action.

- The changes were intended to make it easier to use 142 Trusts a special needs trusts. For example:

  - The section permits not only "incapacitated persons" to benefit, but also persons who are not incapacitated but who meet the federal disability standard.

  - The changes make clear that 142 Trusts can be used for any type of special needs trust, not just for a (d)(4)(A) trust.

  - There's a specific provision permitting non-corporate trustees of 142 Trusts under $50,000. This may offer your organization a way out of being trustee of a 142 Trust that is too small for you to administer profitably.

5. Dealing with Third Parties Just Got Easier. Two changes by the Texas Legislature in 2007 should make it easier for trustees to deal with third parties. These changes may help individual trustees more than corporate trustees, but corporate trustees still should benefit.

The first change involve amendments to Section 114.081 of the Trust Code. This section used to offer protection to third parties who "paid money" to a trustee, making it unnecessary for them to be sure the trustee did what the trustee was supposed to do with the money. Beginning September 1, 2007, the section will apply to third parties who pay money or deal with the trustee in other ways, such as buying or selling property. In general, a person who deals with the trustee in good faith and for value is protected if he or she obtains a copy of the trust instrument or a certificate of trust which shows that the trustee has the authority to enter into the transaction.

The second change is enactment of new Section 114.086 of the Trust Code. This section expressly permits the common practice of permitting a trustee to deliver a certificate of trust to a third party rather than a copy of the entire trust instrument. The statute sets the requirements for the certificate.

Since using a certificate of trust involves less disclosure of information about the trust and its beneficiaries, corporate trustees should consider using a certificate of trust in every circumstance where it is available. Failure to do so may be a breach of trust.

6. Better UTMA Options. The Texas Uniform Transfers to Minors Act (UTMA) was amended to do two significant things.

First, one of the options for custodian at the end of a custodianship (in other words, when the beneficiary is about to turn 21) is to place the custodial property in a Section 2503(c) trust. What's a 2503(c) trust? That is a trust that gives the beneficiary a withdrawal right for a limited period of time at or near his or her 21st birthday. If the beneficiary chooses not to withdraw the property during that limited period of time, the property may stay in the trust beyond his or her 21st birthday.

This particularly will be useful for persons who overfunded their children's UTMA accounts. Now, if they see that they are going to have $400,000 of assets in the UTMA when the kid turns 21, the custodian can set up a 2503(c) trust, give the kid notice of his or her withdrawal right, and hope that he or she does not exercise the withdrawal right. Since I assume corporate trustees rarely serve as UTMA custodians, the key point for you here is that you can offer your services as trustee of the 2503(c) trust to custodians who are in this jam. Some of these UTMA accounts are quite large due to appreciation of assets and would make an attractive trust to administer.

Second, the changes improve the use of UTMA custodianships as beneficiaries of IRAs and other retirement plans. The way the IRS is administering the designated beneficiary rule makes it much more difficult to use a trust to hold a minor's beneficial interest in an IRA. If you are trustee of a trust which is named as the beneficiary of an IRA or other retirement plan, you should determine if the continuing tax deferral is in jeopardy because of the way the trust is written. Most trusts written before 2004 (and many written since then) fail to address the IRS's new designated beneficiary position. Is it a breach of the trustee's duty to fail to point out a designated beneficiary problem? Probably not, since the trustee didn't write the trust, but it is not out of the realm of possibility. Better to raise the point and let the IRA owner make adjustments than to wait for the tax deferral to be lost.

Under the new law, it will be easier for the owner of an IRA to designate an UTMA custodian as beneficiary. The owner has to balance the benefits of a trust (including the ability to provide professional management of funds beyond the child's 21st birthday) with the relative convenience of an UTMA designation and no risk of losing the continuing income tax deferral of the IRA.

7. Everyone's Favorite Topic: Jurisdiction. I'm not going to bore you with a lot of talk about jurisdiction. However, you should know that, if the situs of administration of your trusts is in one of the counties with a statutory probate court (Bexar, Collin, Dallas, Denton, El Paso, Galveston, Harris, Hidalgo, Tarrant or Travis Counties), you can now choose to file any lawsuit brought by you as trustee regardless of the subject matter in the district court or the statutory probate court. Of course, this also means that you can be sued in district court or in statutory probate court in any lawsuit brought against you as trustee regardless of the subject matter.

Previously, it was clear that litigation about the administration or construction of the trust could be brought in district court or statutory probate court. Beginning September 1, 2007, any lawsuit "by or against a trustee" is eligible for district court or statutory probate court. This makes any suit in which a trustee is a party an appropriate case to bring in statutory probate court, assuming that venue is proper.

Note that the "reach out and grab" power that statutory probate courts have with respect to lawsuits related to decedents' estates or guardianships ***DOES NOT*** apply to trust cases. (See Sections 5B and 608 of the Texas Probate Code.) However, if the trust is a testamentary trust (one that was created by will), and the estate is under administration in a statutory probate court, the statutory probate judge may be able to reach out and grab a case involving the trust. Since most independent executors never formally close estate administrations, testamentary trust cases could be pulled into probate court for an indefinite period of time after the testator's death.

8. Notice to Will Beneficiaries. The change that has gotten the probate bar's attention is the new notice to will beneficiaries requirement under Section 128A of the Probate Code. This will impact banks and trust companies if they serve as executors.

In response to a couple of cases of an independent executor who allegedly was out of control, the Legislature amended Section 128A to assure that every person named as a beneficiary in a will gets notice that the independent executor has been appointed. This notice must be given within 60 days of appointment. The court must be notified by affidavit or certificate within 90 days of the date of appointment about the status of notice.

Here are facts about the new notice requirement that you should know:

- This notice provision only applies when will is probated and an executor or administrator with will annexed is appointed. It does not apply to intestate estates, muniments of title, guardianships or trusts.

- If the will makes a pour-over gift and the executor and the trustee are the same person, the executor must notify the income beneficiaries of the trust.

- Beneficiaries may sign and file a waiver of notice.

- Even though the statute applies to beneficiaries "named" in the will, the context makes it clear that notice should be given to all beneficiaries who receive a gift under the will. For example, if the will makes a gift to the decedent's "children" without naming them, each known child should receive a notice or sign a waiver.

- Privacy-conscious persons have to take steps to avoid the need to put the beneficiaries' names and addresses in the court file. For example, if a living trust with a pour-over will is used, consider making the executor under the will and the trustee of the trust different so that notice may be given to the trustee of the trust and not to the income beneficiaries of the trust. This keeps the names and addresses of the income beneficiaries out of the public document.

- There is no exception for small gifts. Every beneficiary -- even a "disinherited" child given $1 -- must receive the notice or sign a waiver. This is another good reason not to give the "disinherited" beneficiary a token gift.

That's it for now. Of course, this information is of a general nature and is not legal advice. Each trust is different, and you should consult an attorney for specific legal advice about a particular trust rather than relying on this summary. If you wish to consult with me or my firm, please contact me.

Very truly yours,

Glenn M. Karisch

Enclosure: 2007 Legislative Update Paper