



Keeping a Private Family Trust Company Compliant

A private family trust company (PFTC) provides families with intergenerational governance over family assets and a private forum for decision-making. Without proper management, however, a PFTC can be exposed to costly litigation and the potential for significant liability. Theft, inappropriate exercise of fiduciary oversight, and violations of statutory or regulatory requirements are just some of the issues that could lead to a negative audit from a regulator, claims by beneficiaries or the disillusion of the PFTC altogether.

Operating a PFTC in a manner that properly recognizes and addresses the myriad risks it faces will enable it to fulfill its core mission for the family. To do so requires those responsible for its management to act appropriately within the scope of their authority, craft policies and procedures that comply with statutory and regulatory requirements, properly document and retain records of critical actions and decisions, and regularly review and verify whether they are, in fact, compliant.

PFTCs are complex and the sheer scope of audit and regulatory risks they must plan for can be overwhelming (see sidebar). By developing and implementing policies that take into account the expertise and capacity of staff and external vendors, a PFTC can ensure it stays compliant and is able to safeguard the family's assets well into the future.

THE IMPORTANCE OF PROPER FIDUCIARY OVERSIGHT

The primary function of a PFTC is to provide proper fiduciary oversight for the family's assets as it manages investments and administers trusts. The PFTC and its management and employees must act in accordance with the fiduciary principles articulated by the law and in each trust's governing documents.

Investments

For investments, this may mean ensuring that those involved in the decision-making process have significant investment expertise and an understanding of how the fiduciary principles affect their decisions. It should be clear how investment decisions are made and who is authorized to make them.

PFTCs need to identify and review the objective and purpose of each fiduciary account, following a review of the governing instrument and applicable law. Then, the investment strategy for the account should be assessed and reviewed in light of the account's objective and purpose. On an ongoing basis the PFTC should regularly update this assessment and review as well as ensuring proxies are voted appropriately. If external investment managers are hired, the PFTC should conduct regular due diligence on an established schedule. This should include exploring

PFTC Policies & Procedures

In order to avoid audit and regulatory risks, a PFTC will need to have a variety of important policies and procedures in place to address matters such as:

Administrative Operations

- Handling board, committee and officer appointments, resignations and removals
- Establishing a business continuity plan
- Reviewing, adding, modifying and removing policies and procedures
- Obtaining Fidelity Bond and other insurance

Tax Requirements

- Filing and paying taxes
- Handling tax refunds and deficiencies
- Managing tax audits
- Addressing the need for restitution

Information Security

- Protecting and sharing client data
- Issuing privacy notices
- Cataloging, retaining and disposing of records
- Responding to and tracking client complaints
- Confirming qualification for trust and fiduciary activities exception under Regulation R

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the firm's ownership and history, investment style and performance, policies and procedures, products and services, and fees, among other things.

Fiduciary Administration

For trusts, proper fiduciary oversight begins with the acceptance of an account and includes the management and termination of the account.

ACCOUNT ACCEPTANCE

First and foremost, the PFTC should consult with the governing documents and the regulatory framework it operates under to ensure they are able to accept the account. Once that is established, the PFTC should undertake a consistent, documented acceptance process, including:

- Identifying the purpose and objective of the account
- Determining whether the PFTC can effectively administer the account, given its staff, resources, expertise, etc.
- Identifying and addressing any potential conflicts of interest
- Reviewing account activity to confirm there will be no AML/BSA/OFAC issues
- Reviewing account assets with an eye toward illiquid assets (real estate, art, oil and gas interests, closely held businesses, foreign assets, etc.)

If the PFTC is a successor trustee, it should decide whether it needs to review the acts of the prior trustee, and whether a release and indemnification from those acts will be necessary. If the PFTC is a co-trustee, it should understand when the trustees must act unanimously and when they will act by majority vote. If certain responsibilities are reserved for a subset of the co-trustees, the PFTC will need to account for that when setting up procedures.

ACCOUNT ADMINISTRATION

Once the account has been accepted, the PFTC should take the following steps to set up the account:

- Obtain the original governing documents and a list of assets
- Prepare a summary of the trust's terms to facilitate proper administration
- Determine if trust assets are appropriate for the purpose and objective, in light of beneficiary needs
- Establish a fee schedule
- Set up reminders for important dates, including:
 - Important filings, such as taxes
 - Tax, insurance and fee payments
 - Mandatory and approved discretionary distributions
 - Termination events

With setup complete, the PFTC should also conduct periodic reviews to confirm that accounts are properly coded, original documents are retained, and distributions have been made in accordance with the governing documents and the applicable laws. There should also be ongoing AML/BSA/OFAC reviews to ensure compliance, and regular reviews to ensure investments are still appropriate for beneficiary needs. All issues identified should be addressed in a timely manner, with an escalation process to ensure proper oversight.

PFTC Policies & Procedures (Continued)

Financial Operations

- Overseeing preparation of annual financial audits and reviewing their results; if audits not required, determining whether to obtain one
- Monitoring liquidity and capital requirements
- Preparing and disseminating financial statements
- Identifying and resolving self-dealing and conflicts of interest through an appropriate escalation process
- Complying with Anti-Money Laundering, Bank Secrecy Act and Office of Foreign Assets Control rules and regulations
- Establishing and enforcing internal controls with respect to recordkeeping, reconciliations, and monitoring and transferring assets

External Resources

- Managing and conducting due diligence on vendors, with additional requirements for affiliated service providers or those who receive confidential information
- Retaining outside counsel

Policies and procedures should be reviewed regularly to ensure they are appropriate and consistent with the objectives and practices of the PFTC and comply with applicable laws.

Disbursements

It is crucial that a PFTC exercises its discretionary powers in a manner consistent with its governing documents and applicable law. Failure to do so may result in adverse tax consequences and legal liability.

Disbursements, such as distributions, fees, taxes and administrative expenses, should only be made if there is a clear process for determining the necessary approvals, and certainty that there are sufficient funds in the account. For larger disbursements, consider requiring additional levels of approvals. All approvals, including co-trustee approvals, should be attached to the processing documentation and stored in accordance with the PFTC's record-management policy.

The PFTC should ensure that the appropriate individuals serve on the committee approving discretionary distributions. This committee should have sufficient information, properly documented, to exercise their discretionary power.

Fees

Fees should be established for each account and reviewed and approved regularly. The PFTC should have a fee schedule in writing specifying the amount and timing of fee payments that can be used to confirm fees have been taken appropriately. Fees should be communicated to clients, co-trustees and beneficiaries who are entitled to receive statements.

Reporting

The PFTC must provide regular reporting to those required to receive it under the governing instrument and applicable law. Typically, statements are sent to current and remainder beneficiaries who are not minors or incapacitated. Some trust instruments or applicable laws waive this requirement.

ACCOUNT TERMINATION

The PFTC also needs to be able to address the termination of a fiduciary account when the PFTC ceases to be a trustee due to its resignation or removal or the termination of the trust. The PFTC should have a process for reviewing the termination to ensure it is handled properly. This process should:

- Confirm final fees and taxes are paid, accounts are closed and account assets are properly distributed
- Determine whether it will waive or require an accounting, which could be judicial or informal, and whether it will request a release and indemnification

In the event of its resignation or removal, the PFTC will need to transfer governing documents to the successor trustee.

STAYING COMPLIANT REQUIRES DILIGENCE AND DOCUMENTATION

Proper documentation and its retention allow the PFTC to confirm that it followed the rules outlined in its governing instruments and policies and procedures. In some cases, this may be required. In other cases, it is a best practice to allow external parties to verify for the PFTC's owners and clients that it is operating appropriately.

Policies and procedures should be reviewed regularly to ensure they are appropriate and consistent with business objectives and practices and comply with applicable laws. If a gap in compliance with policies and procedures is identified, the PFTC may provide additional training to ensure compliance or update the policy or procedure to reflect the current process.

Depending on available resources, the PFTC may wish to develop a process for confirming that the rules are being followed prior to undergoing a regulatory or external audit. The PFTC may have employees with separate duties and reporting structure outside of the area it is reviewing to do sample testing of key areas to confirm compliance. Alternatively, the PFTC may wish to hire external resources to perform a review. If the PFTC opts to use external resources, it should carefully consider the scope and approach of the review to ensure client confidentiality is protected.

Operating a PFTC so that it avoids audit and regulatory risk enables the PFTC to fulfill its mission of providing intergenerational governance over family assets. Failure to do so may divert important resources from its core mission. Through diligence and clear, accessible policies and procedures, a PFTC can avoid the worst-case scenarios associated with audit and regulatory risks.

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