HOUSE OF REPRESENTATIVES
COMMONWEALTH OF PENNSYLVANIA

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House Bill 326

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House Judiciary Committee

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Main Capitol Building
Room 140, Majority Caucus Room
Harrisburg, Pennsylvania

Tuesday, October 10, 1995 - 9:00 a.m.

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BEFORE:

Honorable Jeffrey Piccola, Majority Chairman
Honorable Jerry Birmelin
Honorable Lita Cohen
Honorable Brett Feese
Honorable Al Masland
Honorable Robert Reber
Honorable Jere Schuler
Honorable Thomas Caltagirone, Minority Chairman
Honorable Peter Daley
Honorable Frank Dermody
Honorable Harold James
Honorable Kathy Manderino

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ALSO PRESENT:

Brian Preski, Esquire
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Suzette Beemer
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Galina Milohov
Minority Research Analyst

C O N T E N T S

CHAIRMAN PICCOLA: The meeting of the House Judiciary Committee will come to order. Today is the date, time and place for a public hearing on House Bill 326, amendment to the Decedents, Estates and Fiduciary Code dealing with the removal and replacement of a corporate or individual trustees. The prime sponsor of the bill is Representative Manderino, member of the committee. I note her presence here today.

Our first witness is Mr. Standish Smith, president of the HEIRS Organization. Mr. Smith, good morning.

MR. SMITH: Good morning. The HEIRS Organization wishes to thank Representatives Kathy Manderino and Jeffrey Piccola for the opportunity to meet with you today. We have a number of beneficiaries as well as industry experts who are anxious to discuss with you the need for trust reform in Pennsylvania. H.B. 326 and its identical Senate counterpart, S.B. 770, were developed over a period of four years by a team of reform-minded members of the Trust/Estate Bar, former bank trust officers and beneficiaries of personal trusts.

As you are aware under House Bill 326,

the beneficiaries of a personal trust voting together can remove their trustee without requiring proof of egregious circumstances; a No-Fault divorce as it were. Thus, changing trustees becomes practical for all beneficiaries, not just those with multi-million dollar trusts, but for persons with ordinary trusts worth perhaps, \$25- to \$250,000. With other common sense protections built into H.B. 326, we like to refer to it as a beneficiaries bill of rights.

Why is there a need for a bill such as 326? Let me explain. Have you ever heard of a business that can prescribe the quality of its services without regard to its customer's needs or any particular standards, that can increase prices as well as decrease its costs without fear of losing customers while yielding operating margins of 45 percent; that can ignore customer's complaints and the prospect of lawsuits because it can use the customer's money to defend itself? There is one such business. It's called personal trust.

Many trust instruments omit a trustee removal clause, and when this is the case, a bank trustee enjoys a locked-in customer base, just like a public utility. But, there's a key difference. If I have to buy my water from Philadelphia Water Company and electricity from PECO, at least I know that the water will be bacteria free, the current adequate to run all my household appliances, and that in either case the price will be set by a rate board whose members reflect the interests of both the industry and the consumer.

But, in personal trust we have a unique situation. Practical oversight in the form of a regulatory board or a competitive marketplace is totally lacking. Of course, there are standards of a sort.

For example, in Pennsylvania trustees must be competent, sober and of legal age, investments must be prudent and be fair to both income beneficiaries and remainder interests, distribution of principal must be appropriate and conform to restrictions in the trust instrument, et cetera. But, the rules are open to interpretation.

I'm wondering if I should stop here for a second and briefly explain for members of the audience do not know or understand what a trust is? Should I do that, just take a couple seconds to do that? Would that be appropriate?

CHAIRMAN PICCOLA: Well, the --

MR. SMITH: I mean, I'm sure that you gentlemen don't need that explanation.

CHAIRMAN PICCOLA: Yeah, I believe members of the committee are aware what a trust is. I think most people are familiar with it. I'm sure that will come out in the course - in question and answer.

MR. SMITH: That's why the Mellon Bank could charge off a $700 IRS tax penalty against my wife's trust for a tardy estimated tax payment describing it as a tax payment; not a tax penalty, on its monthly accounting statement to her. That's why First Pennsylvania could pack its own common stock into Jane Leimbach's personal trust account--she's here with us today--stock that suffered severely when the company later went belly-up resulting a lawsuit by Jane against First Pennsylvania's successor, Corestates.

That's why Jim Edwards out in Pittsburgh--also with us today, will be testifying here--can't switch 200 million in charitable foundation funds from Integra to PNC in order to cut its administrative costs in half, a move that would greatly benefit the charities involved. This is real. There's nothing hyped up about this. These are facts, like a document.

That's why in 1992, a major local bank whose name begins with M in conjunction with Bethlehem Steel was able to sell 147 acres of prime Lehigh County real estate held in trust for the benefit of one Nina Machall for $1.3 million even though the same property had been previously appraised at 3.9 to 4.2 million.

In fact, the bank did not advertise the sale but instead, according to Inquirer reporter Stu Ditzen, offered the property privately to 40 real estate brokers, developers and investors, some of which might be assumed were not strangers to the bank through previous business dealings.

That's why the Fidelity Bank can demand a release and get 2 percent termination fee before distributing the trust assets to another beneficiary. That's why John Upp, after agreeing to act as the class representative in a 1992 class action suit supported by HEIRS against the Mellon Bank in hope of recovering a few thousand in so-called sweep fees, wound up being sued by Mellon for 1.2 million, the value of his Mellon managed trusts.

That's why Security Pacific, now Bank America, was able to raise its fees beyond the limits specified in many of its customers' trust instruments and sought to conceal the fact.

Are these cases exceptional? I hope so, but I really don't know. In most cases the complaints are less bizarre; fees rising every two to three years, poor service and investments that sometimes don't grow enough to maintain the trust purchasing power against inflation.

These are real issues for real people, many of whom depend on their trust income to maintain only a subsistence existence. In fact, we estimate that about half of Pennsylvania's estimated one million trust beneficiaries have trusts worth less than $250,000. And what about trust income?

Currently, an average S&P 500 equity yields all of 2.5 percent or $6,250 gross income on a $250,000 principal. But the beneficiaries take will be much less because fees are high on smaller trusts; often 1 to 1 and one-half percent on principal annually, so that in our example the beneficiary would be lucky to see half of that, say $3,000. That's a lot of money to pay for management when it can be in an index fund.

Whenever an individual creates a trust he must have one or more trustees to manage the assets and perform other administrative duties. In so doing, he hands over legal title over the trust assets to his trustees who then have virtually absolute control even though they don't own those assets in a beneficial sense. But, unless the trust instrument contains an unconditional removal clause, a situation which is very often the case with older trusts, trustees cannot be removed except under egregious circumstances.

Sure, it's true that many beneficiaries are undoubtedly quite satisfied with bank management and wouldn't think of changing trustees or simply don't care or know enough to raise a fuss. But there are many others that are utterly frustrated by rules which prevent them from seeking better investment performance and more reasonable fees.

In too many cases, the friendly neighborhood banker that dad trusted with all his banking business has been replaced by an 800 number following its merger with an out-of-state national chain.

It was not always so. Years ago banks acted as trustees merely as a convenience to their wealthier clients. But today personal trust is a major profit center. Yet, there is still an implicit supposition underlying personal trust statutes that commercial trustees can put the interests of beneficiaries ahead of their stockholders and still operate effectively without any form of practical oversight.

It's a system that is unwittingly foisted on beneficiaries by their parents and supported by the very people who adamantly oppose 326, the bankers, and undoubtedly by certain lawyers who are in bed with the banks.

Indeed, fairness would suggest that the trust/estate bar, the very individuals that advise state legislators on probate matters and draft trust instruments would have addressed beneficiaries' complaints long ago. Instead, trust law discourages litigation because not only must egregious circumstances be demonstrated but the incumbent trustee can tap the trust for its expenses.

In a sense and that is not surprising because major downtown law firm are often more interested in feeding business to bank "x" which will reciprocate with other businesses or undisclosed referral fee than in looking after the real needs of their clients, the creators of trusts and their beneficiaries.

How is it that parents create such a financial mess for their families? Of course, the problem starts with the lawyers. So even though dad may wind up with a very sophisticated trust specifically tailored to his particular tax situation, he may not receive adequate counsel on the practical aspects of trusts, issues involving investments, costs and control.

For example, we find that trust creators are not always informed that their living trust will switch from revocable to irrevocable status, in some cases locking their beneficiaries into bank "x" unless these assets are distributed at death.

We find that they are not always warned to include an unconditional trustee removal clause in their trust instrument. Nor do the lawyers mention that any agreement with a trustee should include a waiver of its right to invade trust corpus to recover its legal and accounting costs if called upon to defend its stewardship.

And why should beneficiaries be subjected to ever-increasing fees just because dad was not warned that banks cajole settlors into signing a fee agreement that allows them to forever charge the beneficiaries its standard fee schedule. There's one problem. There's no such thing as a standard fee schedule, because they are, in fact, revised upwards on a national basis not just lender, every two to three years.

Finally, it is no secret banks are adamantly opposed to H.B. 326. We wonder why. I mean, if this is a good business lender, we've been -- they argue that trust creators have the right to lock-in a designated trustee for better or worse, and that it would be bad for business if lawyers could not offer trust creators this option. That's fine. We're more than willing to allow trust creators to deny their beneficiaries any rights under 326. We are willing to make this concession because experience suggests that confronted with the issue, few trust creators would want to do so.

The banker's second major objection is that 326 would revolutionize centuries of trust law. Not really. Technically, this is not so because 326, to the best of our knowledge, does not change or interfere with any existing statutes. What this bill does do, however, is respond to a change in business clime--a change which has transformed personal trust from a service offered as a convenience to a banks wealthier customers to a major profit center.

In fact, during 1992, Mellon class action over fees, it was testified that Mellon had earned an operating margin of 45 percent on overall trust revenues of some $300 million compared to a 6 percent margin on its non-trust revenues. Think about that. We're trapped; we can't go. We're locked into this guy. He can do whatever he wants.

This revelation induced Federal District Court Judge Katz to comment that such fees contributed to, quote, contributed to excessive profit margins and constituted outrageous conduct. 326 will stop such exploitation of beneficiaries because under 326 beneficiaries will be looking over the banks' shoulders. If the banks want to stop losing market share, as they are, and enjoy increasing trust fee revenue, they should follow the policy of Howard Pew's Glemede Trust, the area's largest and probably fastest growing independent corporate fiduciary.

What does Glenmede do that is so different; it's really very simple. Glenmede won't manage any personal trust that does not contain a provision for their own removal. Think about that. This eliminates bad P.R. from trapped beneficiaries. But more importantly, it forces their staff to do the job right or lose the account. That's the discipline that banks don't have. The banks will never do this Glenmede on their own initiative. You must do it by voting for H.B. 326.

Today you will hear comment from

industry professionals and individual beneficiaries, all of whom have come to understand why the system needs changing. If you have the courage to work with us to change the system, you will be not only helping beneficiaries and the banks, but promoting Pennsylvania as a great place to bring one's trust business with consequent increase in county and state tax revenues.

I'd like now to introduce briefly Ted Pollard, at my right. Ted was co-founder of HEIRS. He runs a sister organization, HEIRS and Beneficiaries which was in need because of national publicity and both on TV and national magazine. Enjoys a membership that's even larger than HEIRS. In the interest of saving time, he's agreed to present his remarks to you in written form. Ted has agreed to send the staff another one.

MR. POLLARD: Good morning.

MR. SMITH: Okay. If we're ready to move on, I'm going to ask the rest of the speakers to introduce themselves.

CHAIRMAN PICCOLA: Well, Mr. Smith, I think we'll be on a panel if I'm not mistaken.

MR. SMITH: I'm sorry, that's right.

CHAIRMAN PICCOLA: We will get to them. At that present time, if you are willing, I'm sure members of the committee may have some questions.

MR. SMITH: Absolutely. I'm delighted to answer any questions I can.

CHAIRMAN PICCOLA: Since it's the prerogative of the chair, I'll go first.

MR. SMITH: Okay, fine.

CHAIRMAN PICCOLA: On the first page of your testimony you refer to the trustee, presumably the bank trustee, and its customer's needs. Who are the bank's customers in the context that you use that?

MR. SMITH: Well, I'm always speaking about trust beneficiaries with accounts managed by banks -- trust accounts managed by banks.

CHAIRMAN PICCOLA: Okay.

MR. SMITH: That's always my reference.

CHAIRMAN PICCOLA: Therein I think lies the difficulty with your position because I don't believe the beneficiaries of the trust are customers of the bank. I believe the creator of the trust, presumably a deceased individual --

MR. SMITH: Yes.

CHAIRMAN PICCOLA: -- is or was the customer of the bank.

MR. SMITH: That's a fair statement.

CHAIRMAN PICCOLA: If you could just wait until I finish. So, in other words, the customer of the bank is not the beneficiary. The customer of the bank is in fact the settlor or the creator of the trust?

MR. SMITH: Yes.

CHAIRMAN PICCOLA: Now, I really don't want to get into all the details of some of the allegations that you made in the course of your -- specific allegations about certain specific trusts and trustees. But, most, if not all of them, if they're factual allegations have any basis in actuality would appear there are already remedies in law to surcharge the trustee or to bring action against trustees for either their surcharge and/or removal because it would appear, at least on the face of what you've said, that they have violated their fiduciary responsibility.

MR. SMITH: You want me to respond to

that?

CHAIRMAN PICCOLA: Yes.

MR. SMITH: Okay. Response to that is as follows: What you're saying is correct. There are remedies in law. The practical problem is that, if you got egregious circumstances, you've got theft and fraud, okay, you can forward with something like that. That's rather unusual for a bank to steal. I mean, this would be an exceptional thing for a bank.

But, in order to remedy the situation, first of all, you've got to find independent competent, affordable counsel. If you go to any major downtown law firm, what you're going to find is it's going to become very difficult to hire counsel because most of that counsel -- the firms have business with the banks.

The business comes from the banks to law firm, back and forth. So that they'll finally say, we are delighted to negotiate for you, but push comes to shove we can't litigate against the banks. You might have to go out of the country to find appropriate counsel. That is a real practical problem. Then you have to pay for that counsel.

On the other side of the fence is, that the bank is going, in general, going to be able to take their own expenses in defending their extortion from the trust. So it's a little bit like writing a open check--a blank check.

I think for those reasons alone explain the fact why you see very little litigation against bankers. I would have loved to litigate against Mellon Bank for behalf of my wife for years and years. It's the fact that I can't control what they're going to spend out of her trust that prevents me from doing that. All right. Yes, there are remedies, but, no, they're not practical remedies.

What we do with the bill is try to address that fact by lowering the criteria a bit so that, instead of having to prove a case and set up a contest with the bank, which is what costs the money back and forth once you start, we simply say in the bill, you beneficiaries get together. I mean, you are the best judge of whether you are being serviced properly. Therefore, the judge in most instances has to accept your petition and your replacement trustee. There are some details about that. Basically, that's the reason.

If we did have a practical recourse we wouldn't be here today, because there's no reason to be here today. There would be no argument. We would go to court and fix things up through the court. People don't do that. You can't do that.

CHAIRMAN PICCOLA: Well, I mean, some of the facts that you have alleged in your testimony have substantial dollar amounts associated with them and --

MR. SMITH: Well, if you have here -- If you have a very large trust, if you have multimillions of dollars, you can do anything you want. But most trusts are like $2-,$3-,$400,000. That's not large enough to really want to get into a litigation battle.

CHAIRMAN PICCOLA: For example, one you say is the sale of Lehigh County real estate --

MR. SMITH: That was an exceptional case.

CHAIRMAN PICCOLA: -- appraised at

both, approximately 4 million for a sale price of 1.3 million. That's about a $3 million difference.

MR. SMITH: That's an exceptional case.

CHAIRMAN PICCOLA: Was that litigated?

MR. SMITH: Yes it was. It was lost.

CHAIRMAN PICCOLA: Lost by?

MR. SMITH: By the plaintiff.

CHAIRMAN PICCOLA: By the plaintiff?

MR. SMITH: Yeah.

CHAIRMAN PICCOLA: So the facts, as you allege them, there was some mitigating factor that the Court found that the sale was a proper sale?

MR. SMITH: That's true, absolutely.

CHAIRMAN PICCOLA: Now, I think in fairness, you should have indicated in your testimony that that was the case or what those facts were. I don't know what they were. I really don't know that we need to get into that. But you have presented us with a very apparently egregious set of facts and then we find out now in cross-examination that the Court found against the plaintiff in that case.

MR. SMITH: That's correct. That's right.

CHAIRMAN PICCOLA: So perhaps the appraisal was not a good appraisal or perhaps the value of the land had depreciated.

MR. SMITH: Well, I think my point here is that, why should a case like this come up in the first place? Why was it necessary to have to litigate? They had a lot of leverage is my point.

CHAIRMAN PICCOLA: The courts are there for the purpose of litigation. That's why we have our court system. I'm not saying it's a perfect system. I mean, everything is there. The Chair is taking more than enough time in questions. Do other members of the committee have questions? Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. Mr. Smith, or also you can answer if you want to. One of the points that I'd like to hear you elaborate on is a point that Representative Piccola made, and that is I think one of the reasons that people who view this differently come to the conclusion that they do. And that is the issue of who is perceived as the customer.

I'd like you to elaborate on that a little bit more from your point of view particularly in light of, at least if I'm not mistaken, the fact that by the time we get to a trust being against the person who we have technically already defined and you have agreed was the customer when it was created is deceased.

And so if you could elaborate on that a little bit more in regard with regard to practical litigations for House Bill 326, I'd appreciate it.

MR. POLLARD: I guess the real question is, then, who are these people? Are they in no man's land? They have some relation to the bank but yet they're not customers. So, what are they? Their life may depend on how the bank reacts to them, so that, there is some kind of bond there. I'm quite adamant that they are customers of the bank even though by default they have inherited their position from the trust up, so they can't leave. They're captive. That's the critical key.

MR. SMITH: I'd like to throw in a

remark from John Leimbach (phonetic) who is the guru, if you will, at Yale and very competent. We sponsored a conference a couple years ago at the Bar Association in New York on issues involving trust. He mentioned that, one of his points was that the trust is there for the beneficiary. If there were no beneficiary there would be no trust.

So what he was saying in effect was, that any restrictions or what have you that are in the trust must be for the benefit of the beneficiary. The beneficiaries is the key person. He plays the fiddler of the role. But technically he's not a customer, but on the other hand you have a settlor who's long time deceased and is still maintaining these property rights, if you will, in limbo and yet the trust is created for and about the beneficiary.

Now, maybe the beneficiary is not technically a customer. But, you have to as Leimbach points out, you have to look -- the trust has to benefit the beneficiary. That's why the trust is there. That's why by the same token the bank, what the banks feel about this is rather irrelevant. Does that go to --

REPRESENTATIVE MANDERINO: One other comment in asking you to elaborate; one of the reasons --

MR. SMITH: Kathy, may I interrupt? I have an opinion from a lawyer who reviews these contracts that the bank signs, the fee contracts, all right, with the settlor and then hides these contracts from the beneficiary. They won't release them to the beneficiary, and as the heeded contract; that's how subcontractors sign. They heed (phonetic) it.

REPRESENTATIVE MANDERINO: Just talk a little bit more slowly, please. One of the reasons that I agreed to sponsor House Bill 326 and one of the I guess overall things that concerns me very much about it and that I think is addressed here is the whole issue -- just the broader issue of affordability and what the Catch 22, the beneficiaries find themselves in should they choose to try to move the trust.

You mentioned when you were talking about the current standards is that, absent fraud or something very egregious, those are the standards that the Court is looking at. So, the Court may not be looking at because the law does not allow them to look at the equity of an issue, the fees or something like that. If a court could say these are egregious fees and how you can be eating into 25 percent of the income of that trust, a court can take notice of that but the law does not allow them to say that is reason enough to the trust; am I correct?

MR. SMITH: That's correct.

REPRESENTATIVE MANDERINO: And I guess the one point that I just want to make is that, that if we could fix one thing about the current law it seems to me it would be fixed, the ability of the trustee in defending against their own challenge to their own administration to eat into the assets of the fund, because then I as a beneficiary have to say, gee, if all that fund is spinning off for me is $2,000 a month which I need to supplement my income in order to live and I challenge that, I may erode my $2,000 a month that I need to live on so that there is nothing there because in defending against my bringing a lawsuit, standards of which are pretty much just fraud, I have no ability to control that my whole fund won't be eaten up; is that a correct assumption, right now?

MR. SMITH: That would be a help but it is not going to solve all the problems, because people have to get on with their lives. People have jobs. They have responsibilities. Having to litigate, to go to court, find a lawyer, very difficult to find a decent lawyer. You and I both know that.

Sure, that would help, but that's not going to come anywhere close to solving the problem. Portability, putting competition in the system for free doesn't cost anything to -- you don't need regulatory boards, you need, you know, fancy fact-finding committees.

You just put the beneficiaries in the place of a watchdog. Let them watch their own hen house and they do this for nothing. You get them involved, and the banks, or whoever act as trustees will have to be forced to do a better job. It's so simple.

REPRESENTATIVE MANDERINO: I'm sorry, just one more question. Don't most current, meaning being made now a days in the 1980's, 1990's, compared to trusts that were made a hundred years ago; don't most current clauses -- don't most current trusts include a portability clause and then if they do or those that do, isn't that sufficient?

MR. SMITH: Yeah, I think that's much more common today than it was say 50 years ago, before, you know, before trusts -- see, years ago, as I mentioned in my talk, it was a convenience for the wealthy. It was not a profit center. They just did this because they did it. So in a sense today it's -- there is much more emphasis on fees and what have you. It's sort of indicative of what the system has become that we have to have people that do use trustee clauses. I'll tell you it just depends on the law. Sometimes they are litigated and sometimes they are not.

REPRESENTATIVE MANDERINO: If they are included is that a fail safe against litigation?

MR. SMITH: Well, at least they can say to the bank, if you don't work with me a little better I'm going to take the account out. Now, I've seen escape clauses that really weren't.

For example, the fee agreement drafted by none other than Dave Ross and I think several other major banks used or used to use said that in effect, if you can show that our -- if our costs are out of line you can cause us to resign.

Only problem was, the thing was worded in such a way that the burden of proof fell to you to prove that the bank's costs were out of line. And so, I don't think that particular fee agreement meant an awful lot even though it nominally had escape clause.

It's got to be unconditional. It's got to allow you to walk right away. Some people have -- some people have so much family business coming down that the banks want but they've got leverage. You see, but most people don't. I think that's true. I think it does show in one of those.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Representative Masland.

REPRESENTATIVE MASLAND: Thank you, Mr. Chairman. I would agree with the statement that trusts are there for the benefit of the beneficiaries. I would suggest that they're there for the benefit of all beneficiaries. As

I look at House Bill 326 and maybe Representative Manderino could enlighten me on this point, but I see in the first paragraph that the income beneficiaries are permitted to cast two votes and the remainder only cast one vote and tie goes in the favor of the interest or income beneficiaries.

Why is it weighted in that respect --

MR. SMITH: I'm afraid --

REPRESENTATIVE MASLAND: Just wait. You have to wait until I finish asking the question so you don't drive her crazy because she can only really put something down for one of us at any given time.

Obviously, I think that the answer to the question is the reasons were this way from my perspective is that people who are in your organization are predominately income beneficiaries. Now, would you not agree that the interests of income beneficiaries and the remainder sometimes conflict, often conflict?

MR. SMITH: Not necessarily --

REPRESENTATIVE MASLAND: I mean an income beneficiary wants to maximize income now. They want to get that now so they can have as much as they can while they're here; sometimes, to the detriment of the remainder.

MR. SMITH: May I respond?

REPRESENTATIVE MASLAND: Yes, you may.

MR. SMITH: Okay. First of all, we have agonized -- the voting procedure can be changed. That's nothing lock and said about that. We have agonized over that for four or five years. We finally recognized two facts. One is that there are generally more remainder people than are income beneficiaries, okay, perhaps two to one.

If you had a simple unanimous voting scheme, the remainders would generally win. So, we felt that the fairest way to do it was to give each individual beneficiary two votes, the remainder one, income straight ties. A simple majority vote slants it and income straight ties. Now, that does slant it towards the income beneficiaries as you point out.

But, on the other hand, the income beneficiaries were the ones best noted for creator of the trust. In fact, the remainder of, you know, might have been like three years old at the time that the trust was created. So it had to be a bias, it would seem it should go towards the income of beneficiaries. If somebody has a better idea, we'll be glad to hear. We are just trying to get something here. We don't have to get every detail.

I'd like to respond to your second question which is the national conflict between income beneficiaries and remainder persons. In a sense you're right. But on the other hand, an income beneficiary that maximizes income, and this can generally be done with bonds, is not only hurting the remainder but they are hurting their own interest downstream. Let me give you an example, this is our, you know, reason.

If you took a 3 percent estimated average throw off equity, 3 percent is the average. What we are trying to say is that, there's a cut point where if the income beneficiary uses too many bonds, tries to squeeze that trust with too much income, then not only is he going to cut his or her throat as well as everybody else's throat in the case downstream.

So, the intelligent thing to do is to maximize the equities, and a lot of income beneficiaries don't realize they take less income during early years of the trust with the idea that those equities will grow and provide an ever-increasing earnings base. Then maybe 12 years down the line--this is kind of a cut point, if you will, if you've gone the equity route you are going to be turning off more income than you would if you stuck with the bonds. I'm oversimplifying here, but that's basically what happens. Beneficiaries that have some education in this matter recognize this.

In my wife's case, we always tried to maintain a maximum equity portfolio. We didn't have that much to live on originally. But I knew that eventually those equities would grow and have sufficient income later and, indeed, now there's so much income filing in that I can afford to do what I'm doing with respect to the HEIRS operation. Does that answer your question?

REPRESENTATIVE MASLAND: I think so. Let me just leave you with one comment. It's not a question and you don't need to respond to this; that is, although the income beneficiaries may well be the ones that are better known to settlor, but the settlor also saw fit not to just give them out everything outright. You have to look at the wishes of the settlor.

If we're not going to give them everything outright, I want to save something. I want there to be something there set aside for the remainder. I think those wishes can't be ignored either. You have to keep both in mind. I still do question the two-vote, one-vote scheme, but we'll --

MR. SMITH: We can work that out.

REPRESENTATIVE MASLAND: Thank you.

CHAIRMAN PICCOLA: Representative Schuler.

REPRESENTATIVE SCHULER: Thank you, Mr. Chairman. Mr. Smith, I don't know what page we're on here but it deals with the lawyers. Let me preface my remark. I'm not a lawyer. I don't know that all lawyers are that bad. I've dealt with quite a few and I have a lot of respect for them. I disagree with that part of this process.

But you mention here on this page-- they are not numbered--but you said, it all begins with the lawyers. How widespread is that? You make some accusations that they do not inform their clients of all the options and aspects of this.

MR. SMITH: This is what I get. I don't have a survey on it. I'll get you one if you'd like. We had surveyed these problems, a lot of these problems. We have material available for you in that regard.

No, I don't have a statistical summary of how often that happens.

REPRESENTATIVE SCHULER: But it does happen?

MR. SMITH: It does definitely happen. You talk to people in the field they'll tell you this.

REPRESENTATIVE SCHULER: Well, the people who set up the trust may not be able to respond to that.

MR. SMITH: Yes, you're right.

REPRESENTATIVE SCHULER: The second question on another page, utterly frustrated by rules which prevent them from seeking better investment performance and more reasonable fees. I guess what I'm looking at, better investment performance, I mean, isn't that a very debatable issue?

MR. SMITH: Yes, it definitely is.

REPRESENTATIVE SCHULER: Someone could say I want six percent and other one want one. Who's going to determine that? I look at the bill here and I see where these trustees, special trustees that sufficiently impaired trustees' compensation, sufficiently excessive. Who is going to make those decisions? Isn't that a very nebulous definition? Who is going to make these decisions?

MR. SMITH: Do you want me to respond to that?

REPRESENTATIVE SCHULER: Yes, yes.

MR. SMITH: One of the questions that comes up with regard to your comment there is that, and one of the bankers objections is they're face -- chasing what you call the hot performance numbers from one bank to another, all right, and say, this bank has got a documented performance record three points higher than the bank I'm with now, all right. Then the record goes on as a 5-year record and the bank can't show me those kind of numbers. It looks like I would be better if I would invest with these other bankers.

REPRESENTATIVE SCHULER: It may not be safe?

MR. SMITH: Well, we're getting into a whole another area of, you know, what's risk involved and what have you.

REPRESENTATIVE SCHULER: Well, we could argue that you can get 10 percent over here but six percent over here may be more secured than the 10 percent.

MR. SMITH: That's right.

REPRESENTATIVE SCHULER: Who is going to determine what's sufficiently impaired between the trustees? Who's going to make that --

MR. SMITH: The beneficiaries are going to make that judgment on their own with whatever advice and counsel they wish to seek before they make that decision. I want to make one point to you. I want to make this point very clear.

This is not open sesame. This bill allows you only to make this kind of a switch twice in every "X" number of years. We use 5 years. We'll put in 10, 20 whatever you want.

The point of that is, we want beneficiaries to use this power responsibly. That's the key word. We don't want it saying, oh, put off here, put off there. Look at the numbers. Think about it. Ask yours friends. Talk to the investment bank. Is this as good, whatever and then make a reasonable decision. They don't bother doing that now because they know they can't switch it anyway.

Am I saying that every beneficiary is going to make the right decision? No. Some beneficiaries are going to get caught in the machinery with this much power. But we do limit this to twice in a period, so that helps the banks too, because it cost money to set up a trust. It takes time and effort to set up, you know, an agreement with the bank. Essentially, people would be running all over the place.

REPRESENTATIVE SCHULER: Then we have 5 trustees; we'll assume that.

MR. SMITH: That would be a lot of trustees. One would be more common, two sometimes, three rarely.

REPRESENTATIVE SCHULER: Okay, then one person is going to decide what is excessive?

MR. SMITH: No. The beneficiaries together will decide.

REPRESENTATIVE SCHULER: That's what I want to get at.

MR. SMITH: Whoever's on the trust.

REPRESENTATIVE SCHULER: Let's say there's 5.

MR. SMITH: All right.

REPRESENTATIVE SCHULER: They will make the decision.

MR. SMITH: That's right, collectively.

REPRESENTATIVE SCHULER: Now, back to my original point, what is a better investment? Are we going to have five trustees or five beneficiaries arguing over what was --

MR. SMITH: They're going to decide whether or not they feel a move to another bank or individual trustee would be desirable and they hopefully will get together and discuss this and get opinions and whatever.

REPRESENTATIVE SCHULER: Good luck.

MR. SMITH: Yeah, well, maybe not.

REPRESENTATIVE SCHULER: My other question is, as I said I'm not a lawyer but it's my understanding there are provisions now in existing law, why don't you use those to challenge? What's the reason for not using those?

MR. SMITH: Existing provisions for changing?

REPRESENTATIVE SCHULER: Yes. Doesn't the Orphans' Court have that option?

MR. SMITH: Yes, but as we discussed earlier, to meet egregious circumstances for fraud, theft, what have you, you can't move just because you feel the fees are too high. You can't move just because, you know, you feel that you can get better investment results with somebody else. Those aren't generally --

REPRESENTATIVE SCHULER: Why does the Court take that position?

MR. SMITH: I'm sorry?

REPRESENTATIVE SCHULER: Why does the Court take that position?

MR. SMITH: That's the way it's always been. I can't explain. I don't --

REPRESENTATIVE MANDERINO: Isn't it written in the law these are the reasons you can remove? I think that's what --

MR. SMITH: Yeah, there's case law on this. Thanks Kathy.

REPRESENTATIVE SCHULER: Well, I'm sure there is. There must be some reason for that other than just case law. I still have some problems with our definitions here. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Representative Daley.

REPRESENTATIVE DALEY: Thank you, Mr. Chairman. My only question revolves around protection. The settlor in his or her wisdom creates this trust with certain distributions in the trust.

My only concern is, and I don't know if the question's been asked and I called in the past that I'm concerned that House Bill 326 may, in effect, give the beneficiaries the ability to pressure the trustee or trustees to make distributions that really may not be in the best interest of the trust knowing that at some point the fact that beneficiaries can gang-up on and remove them if this distributions not made.

What sort of protections are --

MR. SMITH: Well, I think --

REPRESENTATIVE DALEY: Let me finish. What sort of protections are there in House Bill 326 that would protect the intentions of the settlor in this matter and also would be the best interest of the trust?

MR. SMITH: Well, I think the answer to your question is, first of all, the controlling element in a trust relationship is as you know the trust document. There are rules set forth in every trust instrument as to the distribution of principle. The rules can be very flexible or they can be very tight. Whatever the rules are they must conform to IRS standards.

I'm not an expert on drafting of these kinds of things, but I think the key thing you're trying to say is that, with the ability to switch, we would have too much power. We could just find a bank to do whatever we wanted to do. I suppose in a sense you're correct in that. Certainly, you would have more leverage. We have no leverage now. We are way down at the other end of the spectrum here.

But anybody serving as trustee must conform to the terms of the instrument and he's got to conform to state and sometimes national law, trust law. None of that changes.

REPRESENTATIVE DALEY: So what you're saying to the committee here under House Bill 326, is that you're shifting actually the intention of the settlor in his or her desires and wishes to those of the beneficiary as to how that trust should have been administered as opposed to the settlor's desires?

MR. SMITH: Well, I don't think it's quite as black and white you might make it, but I think it's definitely a shift in that direction. I want to remind you also, is that it's a collective decision. It isn't just the income beneficiaries. It's not just the remainders. Who are going to be hurt if you take principal out?

Income beneficiaries will be hurt downstream whether they recognize it or not. Certainly, remainders will be hurt. It is a collective decision to make the move, to change. The majors and the income beneficiaries have to participate in that opposed to voting scheme which is what we have in the bill. We can make that tighter or looser to address the problem.

Frankly, if I took a trust to Mellon and PNC or PNC to Mellon, I don't think it would make a bit of -- it would not make any difference at all as far as their administration is concerned. If I took it to a very small bank, I might get more leverage.

REPRESENTATIVE DALEY: I don't think you answered the question, but I think you made an attempt to. I think what you're going to see is trust shopping. You are going to find -- I think you will. I think you will see once a decision is made to take that from Integra or Mellon or PNC, whoever it may be, I think you are going to see it's a whole different ball game.

I'm concerned it's going to be shopping. I think once the genie's out of the bottle it's a serious problem getting the genie back in. That's what concerns me about passing this legislation.

MR. SMITH: Okay, that's why we have the limitation on the number of times you can do that. That can be twice in 5 years, twice in 10 years or twice in 20 years, whatever you think is reasonable. You see, the point is, it's a double-edged thing. You want some shopping. It's the shopping that puts the competition into the system. It's the failure to be able to shop that's causing the problem.

REPRESENTATIVE DALEY: Doesn't that go contrary to wishes of the settlor?

MR. SMITH: No, sir. The settlor wants the financial security of it's children. He does not want his kids exploited. That's what's happening today, whether you recognize it or not, it's there.

REPRESENTATIVE DALEY: Don't you think that he or she will do that prior to their demise; that they will have this constructed in such a way that it would be in the best interest of the children or the beneficiaries?

MR. SMITH: Well, I think that settlors think that they put their trust in their friendly neighborhood bank or that they've known for 20 years and everything is going to be fine and they go on. It doesn't work that way. Because banks merge and you're not dealing with the same people downstream. And I don't think that these accounts being locked in -- This is where the problem begins. You've got to build some flexibility in here.

REPRESENTATIVE DALEY: Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you, Mr. Smith, we appreciate your testimony. Our next witness is James L. Hollinger, who is an attorney and is a member of the firm, Smith, Aker, Grossman and Hollinger.

MR. HOLLINGER: Good morning, ladies and gentlemen. I am James Hollinger. Members of our law firm and I have been involved in Pennsylvania wills and estate practice and in making recommendations for legislation in this field for many years. Our office publishes and edits fiduciary review which is distributed throughout the Commonwealth to lawyers and that deals with recent developments in the state and trustee. We see all the cases that come through in that field in Pennsylvania as well as some other states.

Currently, I serve as Vice Chair for Probate and Trust Law with the Pennsylvania Bar Association Real Property, Probate and Trust Law Section.

At a recent meeting of our section we

considered House Bill 326 and recommended to the Pennsylvania Bar Association that it adopt a position encouraging retention of existing Pennsylvania law which emphasizes the intent of creators of trusts with respect to appointment and retention of trustees. Since the Pennsylvania Bar Association has not acted, I speak today as an individual.

You already heard about grounds for removal. They are set forth in Title 20 of Pennsylvania Consolidated Statutes, Sections 7121 and 3182, and exclusive authority for removal of trustees is placed on the Orphans' Court Division of the Court of Common Pleas.

Grounds include mismanagement, insolvency, failure to perform duties, incapacity, removal from the Commonwealth and an additional broader provision, when, for any reason, the interest of the trust are likely to be jeopardized by the trustee's continuance in office.

It seems to me that we have here more than just a statement that there are grounds that are impossible to fulfill to remove trustees. We have grounds here which approved are the basis for removal. They are based on failure to do the job, failure to produce a proper income for the beneficiaries, failure to have a proper investment performance. Those things are now in our law. We don't need a new bill to do that.

House Bill 326 proposes to permit trust beneficiaries to vote on whether a trustee should be replaced. Obviously, a radical departure from our current law, which would give beneficiaries to whom the creator of the trust was unwilling to give authority over trust assets.

That's why this trust was created because he didn't want these people to have control of these monies either because he thought they needed protection, they didn't have the proper judgment, or whatever reason. He has decided that he doesn't want or she doesn't want him to have this money. That beneficiary for some reason hasn't been authorized to deal with it.

The effect of this authority that's proposed in House Bill 326 would pressure the trustees to make distribution which they might not otherwise have made if they used their own unrestricted good judgment.

The provisions that you're talking about here would really make it untenable for a trustee to act. He would be, as just pointed out, right in the middle every time when he's trying to make his decisions, looking over his shoulder and saying, is this going to mean that the trustees beneficiaries are going to be upset. The trustee shouldn't be in that position. The trustee is supposed to exercise uncontrolled judgment, controlled only by the provisions of the law and the judgment of the Orphans' Court.

Since the creator of the trust made a decision about who he wanted as trustee, Pennsylvania law gives great respect to the choice and it should be disturbed only if substantial grounds exist for removal as we talked about already.

Removal power and authority to appoint a new trustee has rested solely with the Orphans' Court division. There's some discussion about the role of the Orphans' Court. The role of the Orphans' Court is to protect beneficiaries, to protect all persons who are interested in estates. As you can tell from it's name, it started out protecting orphans. So when we're talking about Orphans' Court, we're talking about a court of equity, a court of fairness. This court is the one making judgments about whether the grounds that are asserted are sufficient to have the person removed.

The bill here proposes that what I term as an undesirable imposition of another office, a special trustee to act on removal of a trustee and appointing of a new trustee. The special trustee would be charged with making decisions about the functioning of the trusts which should be reserved to a constitutionally designated judge.

This is important decision making here. We shouldn't have someone just picked off the roll of attorneys or whomever by the judge to make those decisions. It should be the responsibility of the judge who has been selected by the voters to make this decision.

If standards suggested in the bill are vague as they have been discussed. You have sufficiently impaired, sufficiently excessive, sufficiently substandard investment performance. Now, I think you and I might disagree about those things. I'm sure the trustee and beneficiaries may disagree. The testator or creator of this trust may disagree, so that should be something that is left to the judgment of a proper judge in a proper court.

House Bill 326 also proposes to make significant changes in current law by long established rules encouraging persons and institutions to act as trustees by reimbursing them for expense involved in administrating trusts and for successfully defending their acts as trustees when questions are raised.

They are not reimbursed for those expenses if the questions are substantial and the questions result in their being surcharged or removed. There may be certain cases where there's a surcharge. They're required to put back some money. In those cases, they cannot charge the trust for those expenses that they've incurred defending their position. But if they've been wrong, they should pay. That is proper, and the Court will make that determination.

This bill will also alter public policy which encourages qualified trustees in Pennsylvania. I think it puts us at a disadvantage with other jurisdictions which do provide protection for trustees as a matter of public policy. We want capable people managing other people's money. We don't want someone who is the buddy of a beneficiary to be the manager.

This bill would also deny reimbursement to trustees who committed no wrong which would be a basis for their removal under current law. That's a very harsh result. You've done your job properly according to the court's perception and now you're putting a provision that they can't be paid for their expenses. It seems very harsh.

What you've done here is raise the ire of the beneficiaries who then seek the trustees removal without cause.

House Bill 326 would also place additional expenses incurred by beneficiaries seeking removal of the trustee on the trust, as I pointed out, while at the same time depriving trustees who committed no wrong of their right reimbursement for expenses incurred.

One additional provision requires comment. When the creator of a trust selects a particular trustee, he expresses confidence in that person. The bill provides that a substantial change of ownership or management of the trustee should eliminate any presumption that the creator had special confidence in the trustee.

Our laws now in Pennsylvania already provides for the circumstances in the Banking Code of 1965, at 7 Purdon's Statute, 1608(C), which permits any person with an interest in a trust to request appointment of a new trustee if merger of consolidation would have an adverse effect on trust administration, so we've already got that.

Just a few other comments that I'd like to make about the position of this as being cast as a consumer bill. I don't think the consumer that we're talking about is the beneficiary. I think the consumer we're talking about is all of us who are potential creators of trusts, all of us are potential testators here. So all of us are the people who should be protected by the rules of the Commonwealth. All of us consumers; not a small group of beneficiaries who are disgruntled.

The other thing I want to mention was the Orphans' Court -- excuse me -- what is the role of the attorney. Certain statements have been made by the attorney's role. I think that all of us are aware that the client that we're serving is a person who's coming in to have his will or trust made. That's the person we have our loyalty to. Our cannons of ethics require us to be loyal to him in all degrees.

We're not allowed to have conflicts of interest which would interfere with that representation of that person. The rules are enforced by the Supreme Court and lawyers can be surcharged -- can be admonished by the Supreme Court or before the disciplinary board. They can removed from practice if they don't act properly. So there are standards. I don't think it's proper to take the position that lawyers are not protecting the role of their clients.

Most lawyers that I come in contact with will discuss the matters with their client.

If the client wants a removal power in there, the lawyer will see that it's in. That's one of the considerations that's always gone into the drafting of documents.

In summary, House Bill 326 would not make a helpful or desirable change in Pennsylvania trust law. Existing grounds for removal of trustees constitute a fair and equitable basis for removal, considering the intents of the creator of the trust which should be maintained as the paramount consideration when dealing with trusts.

Policy changes proposed by the bill are not in the interests of persons making wills and trusts who are all members of the public who's rights to deal with their own assets should not be imposed on by legislative action.

A small group of disgruntled trust beneficiaries should not be the constituency which produces major policy changes in the estate and trust field, an area of Pennsylvania law which has been a model for national simplification of procedures.

All over the country they've looked at Pennsylvania for drafting of uniform probate code which was a predecessor of current uniform codes going around. We have a proud tradition here in Pennsylvania and we don't want to see it disturbed. Thank you for the privilege of commenting on this bill. Our section in the Pennsylvania Bar Association stand willing to assist the legislature whenever you desire assistance.

CHAIRMAN PICCOLA: Thank you, Mr. Hollinger. I'm going to ask a few questions. I probably know the answer myself to some of them, but as one who practices in this field, I'd like to ask you those questions so that you can give the entire committee and anyone that might be watching this hearing the benefit of your responses.

When a client comes to you and either in the context of estate planning or otherwise wants to create a trust, what are some of the reasons that a client would want to create a trust? Why would they want a trust created?

MR. HOLLINGER: Well, I would say that if we're talking about a trust during a person's lifetime, either a revocable trust or sometimes an irrevocable trust.

Revocable trust primarily would be for management purposes. During the time when the testator's alive, either he's too busy or she's too busy with business, with other activities that they're involved in or they don't feel they have the capability to manage funds. Perhaps they've inherited some money and they don't want to be required to manage themselves. Those would be primary reasons.

Another reason would be, as people age they may think that the alternative of a trust would be preferable to having a guardianship proceeding which requires a court proceedings and sometimes can make that person feel uncomfortable. So they may go in and say, I'd like to set up a trust so that as I age and unable to manage these things, this can be managed by someone who has experience in management.

Other reasons would be for tax reasons. Irrevocable trusts, particularly what we call Crummey trusts selected by some persons using life insurance as a vehicle to build estates and keep the monies out of the estate for tax purposes.

These are primary reasons. Other reasons that persons put trusts in their wills might be because they believe that their beneficiaries are not appropriate persons to handle the money, either because of their own limitations; they may have mental or physical capacities that limit them in such a way that they cannot handle properly the monies that are to be used for them.

There may be tax planning reasons for wills. We see a common two-trust kind of thing with a marital trust and a residuary trusts in many people's wills to take advantage of our federal laws on estate taxation. These would be many of the reasons for trusts.

CHAIRMAN PICCOLA: Would one of the additional reasons might also be the age of the perspective beneficiary? In other words, the creator does not want a child or grandchild to receive funds outright before a certain age?

MR. HOLLINGER: Yes. That's often done. We sometimes see trusts in which portions of the principal are given at various ages in order to give them an opportunity to have some experience with money before they get all the money. So if they happen to make a mistake early, that can be perhaps remedied by experience before the time when they get the balance of the money.

CHAIRMAN PICCOLA: Now, as you read this bill, if such a creator of a trust in a will, for example, puts a limitation on the trust that the child shall not receive the principal of the trust until they reach the age of 30. Let's say the testator dies when the child is 18 or 19, under the provisions of this bill, would not that child have the right to go into these proceedings and change the intent of the beneficiary and the creator of the trust?

MR. HOLLINGER: I'm not sure about that. I don't think that this bill would change the power -- Where you usually see this bill effective would be in the area where a principal invasion is allowed before the reaching of final age when they receive the funds. So that the place where this bill would be effective and inappropriately so in my judgment, would be where there's discretion in the trustee to use principal prior to the time when principal would be passing to the heir.

CHAIRMAN PICCOLA: Okay. Now, as an attorney, when a client decides to create a trust, what kind of decision-making process goes into choosing the identity of the trustee?

MR. HOLLINGER: Well, first thing we would take with them about is, who is their current bank, if they are interested in a bank trustee? I know that some of the bank persons here might not like to hear it, but there are people who don't want banks. They want individual trustees. That's a consideration for some people.

We discuss with them the pro's and con's of particular persons versus institutions as trustees. We talk to them about the questions of whether they want to have removal powers if they do have trustees designated and how long those removal powers should be. We discuss with them the impact of removal powers on the activity of the trust. Those are some of the things that we would discuss.

CHAIRMAN PICCOLA: The final decision as to who the trustee will be is the client's; is that not correct?

MR. HOLLINGER: Absolutely.

CHAIRMAN PICCOLA: Thank you. Do other members of the committee have questions? Representative Feese.

REPRESENTATIVE FEESE: Thank you, Mr. Chairman. Mr. Hollinger, without answering in the context of the House Bill 326, why should there not be some mechanism by which a court could remove a trustee in order so that another trustee could be appointed that charges a lower fee; that possibly has a history of a better rate of return? Why should there not be that mechanism?

As far as I'm concerned the few cases I've litigated in regards to waste and mismanagement, that's almost an insurmountable burden. But why should there not be a mechanism to inject some competition into the scenario so beneficiaries can have maximum assets?

MR. HOLLINGER: I think that's a valid question. I guess the primary thing would be, what is the intent of the testator in this situation? If he has that kind of intention, then I would say it should be written into the document. We should not take a few cases that are hard cases, that may be based on facts that are not fully understood by all of us who hear about them, and use that as the basis for our law in Pennsylvania.

Our Pennsylvania law has been grounded on the idea, what is good for most of the people. Let's keep it as simple as possible for most cases. For the exceptional cases, let's make the Court available to deal with the situation. That's the whole basis of our probate law and trust law in Pennsylvania.

So, I think we have done that. I think the provision that we have, if there's a substandard result in their investment performance, I think that the grounds for removal that we do have, if it's egregious enough, would be that last ground; when for any other reason the interest of the trust are likely to be jeopardized by its continuance in office.

The Court has significant power to act in those circumstances. If it's so terrible and the judgment is unanimous that this is a bad job, then the Court can remove them.

REPRESENTATIVE FEESE: But I'm looking at situations where it's not so terrible. I'm looking at a situation, and I believe prior testimony indicated where maybe a percent or half a percent charge would result in an additional $1,000; $2,000 worth of income which can make a difference in an individual's lives.

Why should there not be that mechanism so that additional monies through some competitor process? I know you said that should be the attorneys -- attorneys should advise the client of a removal provision and I'm sure that you do that and those individuals who practice estate planning on a regular basis do that.

I do not believe that that's done regularly by the vast number of attorneys who write an occasional few wills a year that has some trusts for provision. So why shouldn't we provide that opportunity in that situation since I cannot agree with you that attorneys are doing that?

MR. HOLLINGER: There may be some validity in what you say. To me it seems that we do have sufficient provisions in our law to cover these situations. You're talking about folks who's -- there's a difference between being able to get along and not get along is the return from this particular trust.

That may be true in a few cases, but I think in most of the cases that we find, if we have a really small trust, the Orphans' Court has authority to invade principle even though there's no invasion in principal power if it's necessary for the individual to have additional income. The court judgment is essential. So they can partially terminate a trust or terminate it completely if it gets down to be too small.

Incidentally, I don't think many of the corporate trustees really want to handle a $50,000 trust or perhaps even larger trusts than that depending on which institution it is because they are not economical from their perspective. So, we may be left in a situation where we can only have individual trustees in those cases.

REPRESENTATIVE FEESE: I don't wish to labor the point, but it seems to me that we should not need to take the step to invade the trust where the change of a trustee might result in additional income. That's just a comment. Thank you.

CHAIRMAN PICCOLA: Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. Mr. Hollinger, in your comments in terms of why someone would set up a trust, you mentioned tax implication. Could you explain for me a little bit more what would be the difference -- my understanding is that median size of a trust in this country is $400,000.

If I walked into your office and I had accumulated assets of $400,000 and I was writing a will, what would be the difference that you would advise me in terms of the taxation of that money should I die tomorrow, if it just passed either by will or intestate or if it passed -- or if it was in a trust?

MR. HOLLINGER: In that size of trust, I don't think there would be a difference because federal state tax starts at $600,000.

REPRESENTATIVE MANDERINO: Let's put it at 750,000. I realized that after I gave that example.

MR. HOLLINGER: If we have somebody with 750,000, common thing would be to have some division between -- Are you talking about a husband and wife situation, or not necessarily so?

REPRESENTATIVE MANDERINO: Not necessarily so, but I have some issue. Spouse or not spouse, let's assume I have a spouse and children.

MR. HOLLINGER: If you have a spouse, it makes some sense to make some division of the property between the two spouses and set up a trust to protect it from federal taxation because federal taxation starts at 37 percent rate at 600,000. So just by changing a little title ownership of property, you can save significant taxes for that kind of person.

If an individual has 750,000, it really doesn't change the taxation I was referring to as husband and wife situation. You would still be taxed on the excess of 150,000 extra at 37 percent rate. It's pretty salty.

Alternative I guess is to make plans to give to charitable institutions to things that would not be taxable. Some people will do that and some won't.

REPRESENTATIVE MANDERINO: Am I then,

I guess the -- I'm looking at it from a layman's point of view. I don't practice estate law. But, it seems to me that more potential testators, whether they actually do, settlors whether they actually do establish a trust or not, but it seems to me that more people are doing it for tax reasons on average than for, I don't trust the judgment of the person who is my potential beneficiary?

MR. HOLLINGER: I don't know. That may be the initial perception when people come into our office, but we always discuss that with them and make it clear to them there's no real advantage to trust for tax purposes in this kind of circumstance that you described whether they have over 600,000 and a spouse.

We have suggested, for instance, I just rewrote a woman's will last week who had about $200,000 and two beneficiaries. I suggested to her, and she's in a nursing home and her assets are declining. I suggested to her it's silly for her to have a trust in that kind of circumstance. What she should do and provide outright distribution for the children and she agreed to do that with our advice. In those kind of circumstances, we don't see that it's necessary to have a trust if the people can manage the money.

REPRESENTATIVE MANDERINO: If that's the case, then who's out there creating all these small trusts, because there's lots of them?

MR. HOLLINGER: Well, maybe people without good advice. Maybe it's people who believe that the beneficiary shouldn't have the money. We all have our own ideas about money and how much allowance should we give our kids and all kinds of things like that. Each one of us is entitled to our own prejudices.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you, Mr. Hollinger. I appreciate your testimony. Our next witnesses consist of a panel, Carol C. Macomber and Joseph Staszak and Randy Rolfe. Would all three of you come forward? We're running 25 minutes behind schedule, so if the three of you could identify yourselves for the record and then give your testimony in brief form as possible, and then give the committee an opportunity to ask questions if they are necessary.

MR. STASZAK: I'm Joseph Staszak from Berwyn, Pennsylvania, and I have a residential real estate firm in Bryn Mawr, Pennsylvania. I'm a settlor of trust for my two children who are beneficiaries.

MS. MACOMBER: My name is Carol Macomber, I'm self-employed. I have a French translation service called French Connection. My father left me a trust setup, whereby, I am not a trustee. I'm not a trustee of my own fund, but my two older brothers are trustees.

MS. ROLFE: Hello, I'm Randy Rolfe. I'm a family counselor, before I was a counselor I was a lawyer. My remarks might show that a little bit. I work with a lot of families, basically middle class families that often set-up trusts and have seen them through some of their problems and their situations. I also was a beneficiary in my younger years of a small trust that my father established.

CHAIRMAN PICCOLA: Mr. Staszak, would you like to begin.

MR. STASZAK: Thank you, Mr. Chairman.

Keeping with the wishes of the chair, I'll keep my comments brief. I created an irrevocable trust naming my two children who were minors at the time as beneficiaries of the trust. The trust was seeded with stock certificates that were valued at the time with about $700,000. When I created the trust, I was impressed with the investment performance cited by the folks from the bank, trust department of the bank. Oh, I did -- I set the trust up in 1982. I forgot to mention that.

Since 1982, literally all published U.S. stock averages have risen almost fourfold. And as a result of actions and misactions by the bank, the trust has a current value of less than $500,000. I consider this sufficiently substandard performance.

I have instituted a legal action for surcharge. That action is currently in process. But, the bank won't allow the release of the trust assets to another trust until the law action is dropped, or concluded. To date, all legal costs incurred by the bank to defend itself has been charged to the trust.

In summary, the playing field is not

level. The bank treats the trust assets as theirs and they use the excuse that their actions are prudent. Every time I've called them as to an action they indicate to me that's a prudent action.

Now, the bank has all the leverage. I've looked at this Bill 326 and, of course, removal is not the highest priority that I have because the trust agreement I have does in fact have a removal. It is a later day trust, but you can't remove it if you have a surcharge action. I believe this House Bill 326 provides beneficiaries with the ability to level the playing field. Those are my comments and I welcome questions, Mr. Chairman.

MS. MACOMBER: I've already described who I am. I'll briefly say, as I said my father died in 1986 leaving an irrevocable trust fund with Mellon Bank. Essentially, my two older brothers are trustees and I am not, which means that every time I want to make a change in the fund, in my equities, I have to have -- the bank has to approve it, plus my two older brothers by phone and by written notice. Of course, this eliminates the issue of timeliness almost entirely from the activities that occurred.

And there have been demonstrated -- and I have proof that there have been moments when certain stocks and certain funds have diminished faster than I have been able to sell them or have increased considerably faster than I was able to profit from them, or the fund was able to profit from it. So I'm, you know, upset about the issue of timeliness with respect to the fund that that's completely eliminated.

Also the reason I have this trust fund, or the reason I'm glad I have it is that with the self-employment that I have, there is sometimes a cash-flow problem from month to month, so I depend on the supplement from the trust fund to help me make ends meet. Each year the business is improving, but the trust fund income is necessary for me to maintain my quality of living.

The way it has worked out is, that I'm allowed to remove any capital above $250,000 which is the minimum that must be in the trust at all times. In addition to that, I receive 9,600 per year as my income, which -- or according to my statement is 12,500 or 5 percent income.

But, the Mellon Bank and I discovered, the officer and I have talked about it that if I take out 12,000 a year, in fact, the debit side, the income side becomes debited. They cannot allow that. Since it must always maintain, you know, a positive level, we reduced it to 9,600 per year.

This really works out to 3.84 percent of a $250,000 trust which I feel is inferior to most money market funds or CD's or any other instrument in most banks that I've been invited to participate in. So the experience with my bank trust fund has several negative factors which I'd just like to describe very briefly.

First of all, I should say I represent no one but myself and it may be obvious that trust funds are new to me. I'm not a legal expert by any means. I'm not talking for my brothers who must represent themselves if they wish to appear before you. But my main complaint has been that 8 different trust officers has worked with me since my father died and not one of them seemed to be aware of the history of my funds, of what had taken place before. Neither could they or did they call me to advise me as to major market events that would impact on my fund, either negatively or positively so that, in fact, my brothers and I have been left to be our own investment advisors, which I feel without being able to point to a paragraph of law is a rather negative quality for a trust fund officer or a bank to indicate.

I feel that although we may not be officially clients or customers of banks and it's the testator who is considered the client, there is still a business relationship which has to take place between the beneficiary and the bank for any kind of business to be transacted. This makes us an indirect or secondary client of the bank in my opinion.

With each passing year the formalities that I've had to endure from the bank I feel have increased rather than decreased. There have been events that prove to me that because I'm not a trustee they consider me of inferior importance and that my opinion should not be taken into consideration. I'll give you a specific example.

In June of '94, the bank took upon itself to sell without asking my permission or contacting me by phone or fax 50 shares of Microsoft, and I believe 200 Nynex, and 100 Warner Lambert, and a hundred shares of Royal Dutch Petroleum. I was rather upset about this not because I might, you know, I didn't participate or they didn't bother informing me about it, but because the choice of stocks I thought was terribly ill-timed.

Microsoft was split two for one. As everybody here probably knows it's gone up to 95 or higher since then. I had to call the bank and say, why are you doing this without at least informing me, and found out that they had sent a written notice to my older brothers, which is normal, for their approval, but I had never received the notice that I was supposed to receive in June or July.

I first learned of all these changes that I've missed this year in the statement of June 30, 1994, when I found myself putting question marks to at least five of the six transactions that had taken place in May, wondering where they came from, who authorized them and why I was not informed.

I was told that they had sent out a form for me to sign for approval. But as I said, I did not receive it in time to prevent this from happening. In fact, I believe I received it something like three weeks later for some mysterious reason which I've never be able to find out.

When I protested that I had not been informed, I was told by a certain officer, that I shall not name, that I really should not be so upset about it. They owed my no apology. This was just an action; they did what they should have done. And because I'm not a trustee that really -- it was a moot question whether I was happy or not, which I find rather shocking.

Even if you just consider the fact that, as I said, there is a business relationship here and supposedly they're professionals, they should be considering their beneficiaries as a professional in their own right.

I've already made the point that my brothers and I have never been called by the officers, no suggestion has ever been made to protect or preserve our fund by finding out, for example, what our long-term and short-term goals are. Perhaps working to personalize the relationship better so that in the end both parties would benefit from that personalization.

And, in fact, when I questioned the wisdom of not taking timing into consideration at all, I was simply informed by the employee of department, timing is not taking into account in stock purchases or sales for trust funds, which I found rather amazing, since any other -- of any other investment officer I ever worked with, timing was a very critical element.

And at times even the most sedate and most conservative fund has to act in certain direction to optimalize the movement, the stock market invent or bond invent that's taking place. It can't be frozen in stone. If it is, the market could take off or diminish without the trust fund ever being known. The trust fund being at the mercy of the market so to speak.

Then the thing that also amazed me was that Mellon's own bond and stock funds which they did recommend me to buy, could only be purchased at the end of the month regardless how high or low the interest price might be, or if I wanted to act now or later, I had to wait until the end of the month rolled around to make any kind of purchase or sale for stock funds as well as bond funds.

And then too, you know, I'm a little prejudiced here, I have to admit because I happen to like Merrill Lynch. I've worked with Merrill Lynch since 1981 and I realize that brokerage houses are not on the agenda here, but if I can use that as an example of comparisons since that is all I know.

I can say that the Merrill Lynch officers have offered me always a large variety of funds and income programs to choose from. They have supported me both in information, investment documentation, have called me on the phone even to say, Carol in this particular case, I would. Even if I didn't want to take their advice I was at least contacted and my opinion was asked.

I said to Mellon, since this is not their policy to call and let us know -- Oh, by the way, when I asked them why they never called their individual trustees to let them know about developments or give them advice or even tell them about the status of the firm, I was told that they have so many customers they couldn't possibly set up a personal program of that kind and they couldn't keep track of all the equities in each fund; that would be impossible.

I was also amazed that when I asked them about my fund, they were not able to say, well, it's on my screen right now. I know exactly your account. I'll get an answer to the effect that we will look at your account. We will let you know. We'll get back to you and they're not back to me.

So when I call my broker at Merrill Lynch he has my fund right up there on the screen. He sees instantly what I have and what I don't have, and he's aware of market events of that day, last week, last month, and what is likely to happen in the near future based on his own company's fortitude or ability.

Then the interesting thing too, is that, Mellon only allows you to buy bonds which Mellon purchases for its own customers or office. Again, I have already touched upon that. I don't need to go into detail. But I consider the variety is a little bit, perhaps, incomplete or less than it could be to be competitive.

Then as far as fees are concerned, there are people much more qualified than I had to discuss Mellon fees. I can only say that what I see and what I've heard based on calls to the Trust Fund Department have been something to the effect that it's .016 percent of the total of 250,000 they use as a basis for charges, which I work out if my calculating is right, $4,000 a year. While my income is 9,600 a year that seems a little exorbitant considering the services that I don't get.

I've been very hard on Mellon. I'm not picking on Mellon. As I said, it's only because I happen to be working with them. There are a lot of things they do that I don't understand. I'll leave it to you to decide whether I'm being unreasonable or not.

But when I compare Mellon Bank to Merrill Lynch, who holds my IRA and my WCMA, which is a cash management account which returns, by the way, are really stupendous. I can go into detail some other time. I pay

Merrill a total of $180 a year for both the IRA and WCMA combined. In return for that $180, I get calls, I get advice. I get instant action. I know that they know what's going on. They have the screen in front of them when I call them, and I'm much more reassured they know what they are doing.

Finally, I will say that it seems to me as a modest small business person that if you don't have competition as the cornerstone of your business, if you're not willing to say, my product has to be as good or better as the next guy or I won't survive. It seems to me that there's no point of being in business. Because, if you have a captive audience, a cash cow like we nontrustee beneficiaries represent for banks, then where is the motivation to provide a better product, a greater variety of products, a sincere desire to please the client? I don't see it. I don't see it's there. Although I would be happy to say if I thought it was, I would be just as happy to say it is.

I believe that any law that would freeze all this in place and eliminate the possibility of change or adaption to this competition criteria is actually encouraging mediocre fund administration performance because there is no motivation to do better for clients satisfaction. I do use quotation marks on client. I'll just say business relations that I don't have to get better.

And you've heard this story before about disgruntled trustees, and so on. I just want to say on a personal note, that there isn't anything that I have now that I wouldn't give back if I could have my father. I'm not interested in just using this as a way to get money even though I can show that I'm very timid here, but I would much rather own my own money than live off my dad's trust fund.

But, if I do have a trust fund, then I expect the people I work with to be professional and that is the basis of my submission to you. A plea for that; that we have that for all of us.

In closing, I'll just say that I believe this House Bill 326, would provide us with at least some leverage so we can deal with people who are not measuring up to standards; that we have a right to believe, we have for ourselves and we want for everyone in our position. That is all I have to say. Thank you very much, Honorable Chairman, for giving us this chance to speak, and you panel. I appreciate it.

CHAIRMAN PICCOLA: Thank you.

MS. ROLFE: Thank you, Chairman Piccola, I'm Randy Rolfe, as I said. My remarks are going to focus on the impact of disputes over trustees on the families that I've worked with as a family counselor. I want to begin by saying I think this bill is definitely a consumer bill and it's seems to rectify some imbalance that has been created over the last couple of decades between banks and the families that are beneficiaries of trusts.

My personal experience that I can almost date when this imbalance became stronger in the late '70's, because at that time the bank that was in charge of a small trust my father had set up came to him and said, your trust is too small. What would you like to do about it? We're going to increase fees and it's no longer worthwhile to us to keep your trust. We're trying to encourage voluntary withdraw of all trusts under a hundred thousand dollars.

Us three kids who are beneficiaries of the trust, my father told us about this and said, well let's see what other banks can offer us. We shopped around a bit and they were all doing the same thing. So us three kids said, well, Dad, we trust you, would you be trustee until your death which he did. Our returns doubled immediately. I'm very glad we did what we did. But, I think this happened pretty much in the late '70's, and it has gone on severe imbalance that I think this bill would rectify very reasonably.

I think the issue of who is the customers of a bank, the trustee department is a very special part of a bank in that it has families as customers. It has an intergenerational dimension which no other service offered by a bank does. It's trying to help someone provide for their family in the future after they die.

I think it's very important to focus on the intent of the trust maker. I think this bill does exactly that. The trust makers I know have tried very hard to provide for their beneficiaries. They are not worried so much that they're all going to wrangle; they're all going to spend their money. They just want to be fair and perpetuate their hard earned money as long as possible for the benefit of their children and grandchildren.

The law in general recognizes that remainderman are less, have less power, almost no power. They get what's left. So I think it's fair to give the remainderman a few less choices, less votes. Also, of course, there are many more of them.

The primary beneficiaries, they are given money and in most cases they're the parents of the remainder of the people. So there's a presumption that the income beneficiaries are going to preserve the fund for their remaindermen and in most cases, also, this is true.

I think it's very important to recognize that this is not -- we're not trying to assume that in the most extreme cases where there are conflicts between generations but rather focus on preventing the problems.

I feel this very strongly because

that's one reason I moved from law to family counseling. I wanted to solve the problems before they got started, and as a family counselor I have seen a number of families that experienced chronic stress and chronic conflict among family members just trying to decide what to do about a trust.

They often have falling-out about two basic issues. One is, how bad is it, what the bank is doing and there is often an imbalance in information? There may be someone who's more knowledgeable and is not embarrassed to call the bank and try to find out what's happening and develop some personal relationship with someone at the bank and then another sibling who doesn't have the knowledge or the guts or the time to find out what's going on and you get some imbalances.

Then you get different perspectives and one thinks that the trust is being handled well and the other not so well. Eventually -- That's natural. That's going to happen, different perceptions of the trust. But the problem comes when it -- really, everybody starts to see that the income just isn't coming in. Strange decisions are being made, communication is poor, and at that point what I see is a major conflict about what are we going to do about it?

There's a huge leap in effort and money at that point. If you go to a court over something like this, the burden of proof is virtually impossible for a family of a small trust to prove that a bank has been bad; that they've been negligent; that they've been fraudulent.

And normally what happens often is the widow or widower doesn't even want to claim this bank that's been that way because they love the trust maker and they don't want to have in their own mind, well, now I'm saying that my former husband choose the wrong people because these are bad people.

They don't even want to make that accusation. So, there's an emotional end to that; that the widower or widow doesn't want to go against what the trustee, that the trust maker choose, even though they may have changed their name, merged, this individual trust officer died, and so on.

Then the biggest problem comes when who is going to pay for it, and there may be very unequal situations where one, I mean, you got a young investor in his 20's. He doesn't have a family and he wants to go for it, and go for broke and take it to Supreme Court. His two older siblings have two or three kids and trying to get them through college and can't afford any money to fight the bank. Yet, they are even more concerned about how little money is going to be left for their children, as a remainder.

So conflicts are chronic and there's the feeling of helplessness. It is the worse thing that I see in my clients. I think that is what we don't want to have in Pennsylvania families. We want them to feel that they do have control over their future, over their financial life.

When I look at this bill, I think that it's very reasonable in that it doesn't imbalance things to the point where the beneficiaries have too much control. I think it's very important to point out that in the bill the Court approves a special disinterested individual, trustee, it's perfectly straightforward, court procedure. The Court isn't going to appoint the older brother as special trustee. It's going to be a disinterested trustee.

It goes through the Court. If the Court doesn't like the trustee's beneficiary proposed that's going to make these ultimate decisions about whether to move a trust or not, the Court can suggest that maybe they should go to some other. They don't think the uncle is disinterested enough or family friend of one of the children, then the Court will suggest find a different special individual as disinterested trustee.

I think the whole process is very much under the control of appropriate authorities to see that no beneficiaries overwhelms the others.

At the same time, the beneficiaries do feel empowered ones or twice every five years to take a look at what's going on in their trust. I think it reminds me of the way CD's operate. The banks are willing to pass very high interest rate if they know they can hang on to that money for six or nine or eighteen months, or whatever it is. I think it's kind of unreasonable to think that banks are going to be pressured to go against a trust instrument. That's their job. That's why we make them fiduciaries because they are going to debate the trust instrument.

In my experience with families, very often the problem is really the other direction; that there is appropriate discretionary right to enter principals and banks don't do it because they'd rather have the principal continue to earn fees for them. That has also come up in my family 50 years ago where it took some real aggressive action to get principal distributed that should have been prior to the time when the beneficiaries realized it.

So, usually the pressure is the other way. An invasion of the principal that is otherwise appropriate that banks might say no; and that the bank knows that they need to be responsive to this family as customer, they will take a harder look at this and, perhaps, give better service and stay on top of the trust and realize that their customer is the family.

Just a couple more thoughts. I think tht the family needs to be able to change the trustees so that they don't have to meet that high burden of proof of fraudulence. I think that we need to focus on family harmony. I think this bill is designed to create family harmony. And I actually am quite convinced that this will be much better for banks.

They'll get a few disgruntled families that take their business anywhere. If they're doing a decent job or competitive job, they will get clients as well. They may have a few more changes, but it's just like choosing who's going to carry your first savings account. I had to decide what bank I was going to put their first savings accounts in, first checking account.

That may change if the service people are bullying my teenagers but it may not if they do a decent job, we'll stay with them. I think we need to focus on who is really going to benefit from this bill. I think it is the families of Pennsylvania who are served by the banks. We want to trust the banks. We want to give them this trust business, but it is fair to introduce a little more accountability and responsibility towards the families that are the customers. Thank you.

CHAIRMAN PICCOLA: While the court

reporter is changing papers, we'll entertain questions from members of the committee? Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. Mr. Staszak, I'm curious. Part of the discussion that we had earlier with regard to different views of this bill dealt with, who was the customer and the difference between maybe an expectation of a settlor now deceased versus beneficiaries, but you were in a different situation. You are a settlor still here. I guess I'm confused as to what is holding you into a relationship that you clearly don't want because your intent seems to me in terms of wanting to move your trust is pretty clear. What am I missing?

MR. STASZAK: Well, we have filed an action for surcharge.

REPRESENTATIVE MANDERINO: Explain that.

MR. STASZAK: We have sued the bank for failure to perform. They will not release the assets of the trust to another trustee until that action is resolved.

REPRESENTATIVE MANDERINO: But you are

the settlor. So what am I missing that is supposedly in every other document but not in yours that just doesn't allow you to pick it up and move it?

I mean, am I mistaken that that's what was explained earlier as -- what's not written into your document that would have allowed you to pick it up and move it or what am I missing here?

MR. STASZAK: The action of the bank. Removal is permitted in the document, but they won't let it go until the lawsuit is concluded. And that's from their attorneys. That is from their attorneys.

REPRESENTATIVE MANDERINO: You had a removal or a portability clause in there?

MR. STASZAK: Yes.

REPRESENTATIVE MANDERINO: Thank you. I guess my next question is for Ms. Rolfe. You said you had currently practiced law. Was it in the estate or trust area at all?

MS. ROLFE: No, it was not. It was in general family law.

REPRESENTATIVE MANDERINO: Okay. Well, perhaps in my question then I'll ask it anyway because you did mention it, but if it's beyond your expertise, that's okay. But one of the other things I guess I have been hearing differing opinions on is the grounds by which one can currently in a legal action remove a trustee. I hear some people say that it pretty much has to be fraud and you had made that remark. I hear others saying that the burden is much less.

What is your experience that leads you to believe or what do you base your perspective on that there is this high burden of fraud?

MS. ROLFE: I have been involved in one case where I looked up to see what basis one could even bring an action against the bank much less get removal. It was virtually fraud. Basically, what we would consider in other areas of the law negligence. You must prove they've been done something wrong.

REPRESENTATIVE MANDERINO: Negligence is a lower standard than fraudulence?

MS. ROLFE: Yeah. No, I don't think it's quite fraudulent but it has to be neglect. It has to be negligence; something that's lower than accepted standards. Something that a reasonable man would say, well, that's not right, that's wrong. It's not just well over a course of history that they really done a poor job compared to the average. It's not that standard at all, which is the kind of standard we're looking for in this bill. It's much more negligence.

It's also how the courts enforce the law. They do tend to favor the corporate defendant. But, it is a standard that you must show they've done something wrong and have it well documented, which costs the family so much money to get those documents. They're almost illegible to most normal people and they have to get experts, not only lawyers, but accountants to read them. The money and time is prohibitive in most cases.

But the standard it is generally, the way it operates is that you must show that the bank has been bad; has done something wrong. You have to document that. Everybody else is doing this. You're doing something else. So it's very, very hard for families to prove and they almost always lose when they do put out the money and then get a lot of bitterness and everybody, you know, a sister telling her brother I wish we should not have done this. They never speak to each other again.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you very much for your testimony this morning. We appreciate it. The next witness is Elyse Rogers, who is an attorney with the Harrisburg law firm of Metti, Evans ad Woodside.

MS. ROGERS: Good morning, ladies and gentlemen. My name is Elyse Rogers. I'm a partner in the Harrisburg law firm of Metti, Evans and Woodside. I practice predominately in estate and business planning area and I have been in practice for 11 years.

In the course of my practice I have had occasion to represent trustees. Both individual and corporate, beneficiaries, of current trust and beneficiaries who will be beneficiaries of trust to be established in the future and many settlors of trust and persons who have provided in their will's for the establishment of trusts that are to be funded in the future.

Before I address trust specifically in this bill, I would like to a comment for a minute on the rules of professional responsibility as they relate to my representation of clients. We are, we attorneys are governed by the rules of professional conduct.

We are prohibited from representing a client if the representation is materially limited by our responsibilities to another client or to a third person unless we believe that the representation will not be adversely affected and the client consents after full disclosure and consultation.

Loyalty is specifically targeted as an aspect of our representation of clients and comments to our rules. Our loyalty is imperative. We cannot think and act independently in giving advice to a particular client.

I think that these rules are taken very seriously by attorneys in Pennsylvania. When the context is the representation of a trustee, a beneficiary or a settlor, this means that we must represent our clients without regard to any pressure from any competing source.

It means that we must provide full and fair advice and counsel to our clients including choices with respect to the selection of a trustee, whether the trustee should be a corporate trustee or an individual trustee.

It also means that we have a responsibility to discuss the advantages and disadvantages of trusts including the limitations on flexibility that are inherent in trust. This does not matter where the client came from or who the source of the referral is.

I learned in law school that there are three things required for a trust: A trustee, a beneficiary and assets subject to a trust. Most trusts are subject to written agreements between the trustee and the settlor of the trust and are established for benefit of the beneficiary, but trusts are more than contrast.

Just the word trust implies the type of relationship that the settlor and the beneficiaries are to have with the trustee. It is a special relationship. Fiduciary duties are not imposed on all parties contrast in

Pennsylvania, but they are imposed on trustees.

In my written testimony I have set forth a quote from Mr. Justice Cardozo that has always stated to me in representing clients of special trustee beneficiaries; the idea that a trustee is held to morals stricter than that of the marketplace. The trustee's duty is to represent the interest of the beneficiaries and settlors and not to represent the interest of the trustees.

This does not mean that trustees are not entitled to compensation. That's true whether or not they are individuals or corporate trustees. It also does not mean that trustees are held to super human standards. In the investment context, and I gathered a great deal of the testimony has regarded investment performance, the care is that which a prudent person; the care that a person would take in the management of his or her own assets.

The other thing that is distinctive about a trust is that there is no single owner of the assets in the trust. The beneficiary, the settlor and the trustee, none of them own the assets. The rights of each are defined by an agreement. It is the settlor for the most part who sets the rules in the trust agreement.

At some point in time most trusts become irrevocable, unchangeable. Sometimes that happens when the settlor establishes the trust. Sometimes that happens on the death of the settlor. At that point in time, the rights of the beneficiary define and are limited by the trust agreement. And rightly so, because sometimes the rights of the beneficiaries are going to be inherently in conflict.

As far as the trustee is concerned, the responsibilities of the trustee are defined not only by the trust agreement, but also by a very well developed body of law in Pennsylvania governing the standards for trustee's conduct.

I have been involved in estate planning for the entire 11 years that I have been practicing, and it seems to me that there are four primary reasons why persons establish trusts.

First and probably foremost are concerns of the settlor about the ability of a beneficiary to manage trust funds. The second and almost as important is a concern that the beneficiary might be victimized by other persons or that their assets might be at risk because of designing persons.

Third, a vision. I use the term vision for the funds that a trust is really the only way to fulfill. Sometimes that's a charitable vision; sometimes that's a family wealth vision, but the trust is a way to fulfill that. The fourth reason people establish trusts is for tax reasons. There are very good tax reasons why trusts are used.

I'd like to elaborate on those four reasons briefly. As far as the manageabilities of the beneficiaries are concerned, the truth of the matter is, most people like to be in control and most people have more confidence in their manageabilities than manageabilities of people that they love.

That might be right or wrong or fair or unfair, but it is true and it's particularly true when older persons are evaluating the prudence and the manageabilities of younger generations.

When manageability is a concern, a trust is a very appropriate vehicle for the management of those funds. Sometimes lack of confidence is temporary. If trusts are established for young children, without tax motivation generally those trusts will terminate either at one time or in staggered phases as children reach a certain age.

There are some beneficiaries, either because of lack of maturity, or personal irresponsibility or perhaps a disability of some sort that the settlor of the trust should never end until the beneficiary is deceased, or some time after that beneficiary is deceased.

Manageability, maturity and responsibility are real concerns of clients of mine who choose to establish trusts. There is also an issue of values. Most of my clients have worked very hard to accrue their estates. They understand a work ethic. They believe in a work ethic. They do not want to pass on a trust fund to their children to encourage their children not to work; not to have that kind of an ethic.

There are many occasions where access to funds are restricted either permanently or temporarily simply because there's a desire that the beneficiary have a work ethic and know how to be self-supporting.

The second characteristic, possible victimization of the beneficiary, very, very common. I have many clients who will tell me they have the utmost confidence in their spouse or their child or their grandchild, or whoever their intended beneficiary is, but they detest the potential beneficiary's spouse. They view that spouse as a designing person after the beneficiary's money.

Right, wrong or indifferent, many, many clients feel that way; or, they feel that the beneficiary is gullible or has too soft of a heart, will part with funds too quickly. A trust fund is a valid legitimate way for that settlor to protect the beneficiary from his or her own generosity or feelings for somebody who might unduly influence them.

As far as visionary trusts are concerned, there are objectives of settlors that can be fulfilled only through trusts. Sometimes the real concern, particularly in both the charitable and in what I call the family dynasty situation, a concern of the beneficiaries don't share the vision.

A settlor may wish to establish a fund that will continue as long as they can against perpetuities last and have a vision for an eventual large amount for the family. The next generation might be interested or the settlor perceives that the next generation might be spending those funds and dissipating when they're not worrying about whether there is something for the grandchild.

With a charitable organization, usually it's just a use of funds issue. For example, in a church context where a settlor might want to refund trust for a church, they may feel very strongly that the money to be used only for programs and not capital improvements, or they might feel exactly the opposite. It should be used only for capital improvements and not the programs.

A trust is a way for that type of settlor to provide a benefit, but a benefit that is tailored to what the settlor needs; not to what the beneficiary thinks it should be.

As far as tax motivations are concerned, both the unified credit, the maritable deduction, the generation skipping transfer tax exemption are all tax-saving opportunities that usually involve the use of a trust.

For some settlors tax savings will be the only reason that they would consider establishing a trust, and almost always in those context there is a way to structure the trust so that the beneficiary or someone friendly to the beneficiary is a trustee of that trust.

I often describe tax savings, trusts in terms of flexibility. With a truly individual trustee this can be a very broad range of rights and powers given to the beneficiaries. A less broad range of powers if the beneficiary is to be the trustee or perhaps a co-trustee.

I present that to the clients as a choice of himself, do you want the trustee in broader powers? Do you want a beneficiary trustee but a narrower restriction of provision providing the beneficiary's rights in the trust? Some settlors want one and some want the other. And it's really a matter of their preference.

With respect to House Bill 326,

whatever the motivation for the establishment of a trust, one of the most essential elements is the independence of the trustee. In order to accomplish the objectives of the settlor, the trustee has to make ongoing decisions that are tough decisions. They are to be true to the trust agreement. They are to reflect the intentions of the settlor who may or may not be alive. They must balance the interest of all the beneficiaries, both current and future, living and perhaps not yet born. Sometimes this will frustrate the living current beneficiaries of the trust who often will view the trust funds as, quote, theirs in a way that the settlor never intended for it to be theirs.

I have highlighted in my testimony some of the areas that are of particular concern to me in this proposed legislation. The first is the vote that's weighted in the favor of the income beneficiaries; two votes for every income beneficiary, one vote for the remainderman, and the income beneficiaries breaking the tie.

I view the interest of the income beneficiaries and the remainderman as almost inherently conflicted even if they are parent and child, even if they have a good relationship. A trustee's responsibility is to balance the interest of both of them. I am not sure how waiving trustee selection decisions, should some version of this bill be passed, balances that interest. I think that the remaindermen are very much shortchanged. I think there will be a real incentive to provide for trustees who will only represent the interest of the income beneficiaries.

Often it is the future people, the people who are not in a position to protect themselves; the children, the unborn children, and the grandchildren that the trustee is trying to protect to preserve something for in establishing a trust. I think they're weighed in the favor of the income beneficiaries would really be contrary to the desires of most settlors.

The second matter that was of concern was the specific identification of the Court of Common Pleas when most counties have Orphans' Court decisions who already have jurisdictions over trusts legislatively. I am not sure if that was an attempt to change the appropriate forum for jurisdiction over a trust. But it seems important to me, and most provisions of the Pennsylvania State Probate and Fiduciary Code refers specifically to the Orphans' Court Division and not to the Court of Common Pleas.

The third aspect of the bill that I found very troubling was the language sufficiently impaired, sufficiently excessive and sufficiently substandard. I have no idea what that means. I suspect that many specialists interested, individual trustees will in fact be attorneys if some portion of this legislation is passed. I don't know how that is to be weighed. I don't know what that means. That's very subjective. Perhaps a subjective criteria would make that more appropriate.

The other aspect of the idea sufficiently impaired working relationship which probably was that it seemed to be a subtle shift in the relationship between beneficiaries and the trustees. I do not think Pennsylvania law recognizes what I would call a working relationship in the sense that there should be or is a mutual decision making.

In an ideal world that might be

appropriate, but in an ideal world that was left to the beneficiary, and the beneficiary would have something made for the trustee under those circumstances. Trustees have a responsibility, a very high responsibility to beneficiaries and certainly have a responsibility to communicate, but I'm not sure what working relationship means in the context of this bill.

As far as compensation is concerned, there are already two existing provisions in the PPF Code, Pennsylvania Probate Fiduciary Code, that deal with trustee compensation. The Court has very little discretion to permit compensation which is appropriate under the circumstances and also to allocate that compensation to be principal in the income.

As far as substandard investment standards, I think the primary concern with this is the ability to institute removal proceedings twice in a 5-year period. I'm not sure how investment performance can be measured fairly when most investments are measured over a 5 or 10, or even a 15 or 20-year cycle. Every two and a half years with fluctuations in the market make a very responsible and prudent trustee or very irresponsible and imprudent.

The other two aspects that concerned me were costs and expenses and the notification requirements. There really is no disincentive for a disgruntled income beneficiary every few years to bring a proceeding to remove the trustee; no economic risk at all. Either the trustee or the principal bears the costs; whether or not there is any justification for it.

It may be that legal process is expensive and it may be that people think very hard before they institute legal process, but a process that allows people not to behave responsibly because they incur no personal economic risk seems to me to just invite proceedings that are unnecessary, and the Court would be involved in these proceedings since they are to be appointed in supervising the special interests with the individual.

As far as the notification is concerned, I know there are many individual trustees of irrevocable trust. I don't know how they would be in any better position than the income beneficiary to know about and comply with the notification provisions in this bill.

It also is somewhat disturbing to me that this legislation would impose a duty on private citizens to advise other individuals as to the state of the law when, in fact, I can't think of another instance where something like that -- I'm not aware of another provision like that in the law where a party to a, quote, contract or agreement has a duty to advise the other of changes and updates in the law.

In closing, I believe this proposed legislation appears to be prompted by frustration on the part of income beneficiaries of trusts. Frustration is readily understandable and some cases it's reasonable. There have been great changes and I have noticed these in the years that I have been practicing in the nature of the bank customer relationship.

Banks have consolidated. Trust departments have been consolidated and they have moved out of especially the smaller towns so that, for example, there is financial institution in Carlisle that had a very active trust relationship at one time. All the paperwork that's processed through Pittsburgh now and all the trust officers are located in Harrisburg. That is absolutely frustrating for trust beneficiaries.

My clients who are beneficiaries are frustrated with this and I understand some of it. Some of it I think is a frustration arising out of a lack of control, but the lack of control was frankly very deliberate on the part of the settlor of the trust.

In advising clients I have noticed a great reluctance to name financial institutions as trustees. I have advised on the pros and cons. The independence is certainly a pro of a corporate trustee; also the continuity that there will be somebody there, good, bad or indifferent. There's a great deal potential for abuse of individual trustees whether it's from sloppy record keeping or outright misappropriation. Those things happen much less frequently with corporate trustee contact.

Understanding and actually having been involved in one removal proceedings and number of negotiations with financial institutions who are serving as trustees to either clean up their act or resign as trustee, I think that it is important for financial institutions and individual trustees to be responsive and to communicate with the beneficiaries.

I don't think, however, that this proposed legislation is the answer to that problem. I can foresee and have been advised by older attorneys in my office that they would probably advise their settlors to at least attempt to opt out of this legislation in trust documents, explaining to the settlor that this may give beneficiaries the power the settlor doesn't intend.

It may also mean that the site of trust may be located outside of Pennsylvania and that actual business will be lost for Pennsylvania trustees if this legislation is enacted. Thank you.

CHAIRMAN PICCOLA: Thank you, Ms. Rogers, for your very illuminating testimony. Anybody have any questions? Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Ms. Rogers. I also found your testimony very educational and beneficial.

Since you have the benefit of having

represented, as I assume most lawyers who practice in this area, both ends of the pie, if I can call it that, the settlors and his wishes and then the frustrated beneficiaries then, I would like your -- from your personal experience, your perspective on the ability right now -- I think I asked the question of a couple different people about the ability to remove right now and what the standard is and how the Court does that. It seems to still be getting not a clear picture of how high that burden is to meet.

Maybe by way of example, one of the examples that we had in the last panel, assuming that it's true, and I'm making that assumption; but assuming that a trust that's spinning off about $9,600 a year in income is being charged $4,000 a year in fees; assuming that that is true, is your experience that that would be sufficient grounds to get removal of that bank under the current law should the trustee, I mean beneficiary choose to bring that action today?

MS. ROGERS: I don't think that a court in Pennsylvania would remove a trustee for that level of fees. However, the Court ultimately has jurisdiction to determine whether or not that is a reasonable fee and whether or not it will permit that fee given all of the circumstances surrounding that account.

In addition, the Court has authority to surcharge that trustee if it finds that compensation has been excessive. There is no doubt that -- certainly from an income beneficiaries and perhaps a remainderman's perspective, somebody is paying for those fees; they are, and they will seem excessive.

In the context of the brokerage firm versus the trustee, the brokerage firm perhaps is not quite so disclosing of the fees that it actually makes on an account as the trustee. Part of the trustee's exclosure responsibility could be to clearly set forth that compensation.

REPRESENTATIVE MANDERINO: With regard to the issue of who pays for a challenge to -- a challenge to the trustee's administration. In the example that we just used, say a court determined yeah, this isn't grounds enough to remove the trustee; meaning, 45 or 50 percent fees compared to income; that's not high enough but we do think those fees are excessive, and so therefore, the Court makes some sort of order to either modify fees or whatever.

Obviously, the beneficiary paid to bring that action from their pocket. Where did -- does the Court also -- Isn't that considered a, I'm being very simplistic here but it's the only way I can understand it. Is that considered a win from the beneficiary's point of view so that none of the assets of the trust are then touched by whatever defense or expenses that the bank or the other trustee had?

So that, if I think I have a reasonable argument the risk really isn't there that I have to be concerned that I'm going to deplete my assets that I'm trying to preserve? How does that play itself out from your experience?

MS. ROGERS: Essentially, the Court has the discretion to determine where the trustee's fees are to be charged. The Court can require the trustee to pays its own fees or it can charge it to the trust fund or it can divide it between the two.

Our office was involved in a removal and surcharge proceeding earlier this year against a corporate trustee. Very large dollars were involved, and I know that the trustee's fees were in the hundreds of thousands of dollars and they were not charged to the trust funds.

REPRESENTATIVE MANDERINO: Is that your typical experience?

MS. ROGERS: I don't know --

REPRESENTATIVE MANDERINO: Or is it hard to say what a typical experience is?

MS. ROGERS: It would be unfair to say what a typical experience is.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Representative Feese.

REPRESENTATIVE FEESE: Thank you, Mr. Chairman. Ms. Rogers, I have a question about the Court determining reasonable and just compensation. Would the evidence of the Court consider, would that be evidence of what is being charged in the industry rather than what might be negotiated with another financial institution with regard to fees?

MS. ROGERS: I'm not sure if your

question goes to financial institutions authorized to act as trustees?

REPRESENTATIVE FEESE: Yes.

MS. ROGERS: Okay. I would think, frankly, the Court would take both into account and the Court would look at all of the factors surrounding this particular trust administration at hand. But, certainly in an negotiated fee and I did not address negotiate fiduciary fees. Certainly for smaller trust accounts there's not a lot of leverage for negotiation in fees.

In larger trust accounts there is room for negotiation in trustee fees. That is something that when it is a possibility the client should be advised of the possibility of renegotiating this accounted fees for corporate fiduciary. I think the Court would take both into account.

REPRESENTATIVE FEESE: My concern is is that in a number of the petitionaries whether it be legal fees or whatnot, the evidence is always what's generally being charged in the profession, whether it be legal profession or banking profession. And if we lack competition right now because trust cannot be moved from a one financial institution to another financial institution, are we seeing truly what is reasonable and just compensation? Are we seeing an inflated fee from the financial institution rather than a fee that would be lower if we can inject some competition into the process?

MS. ROGERS: My impression is that it's very competitive. My impression is that because it is not unusual on a monthly basis to be asked to lunch by some representative of some financial institution who is trying to sell something to some of my clients. I think there is an intense amount of competition out there.

I also think that a prudent corporate trustee has to look for the future. If they provide lousy service to a beneficiary, that beneficiary is, 1, not going to bring additional business to that bank and it's not going to encourage anybody else to do that.

So I think it is, 1, very competitive, although it may not be competitive in terms of the freedom of an income beneficiary to decide that this particular trust fund goes from here to there. I think it is very competitive in terms of trying to attract that business in the first place and trying to attract spinoff and referral business from that person. I would freely admit to you that there are financial institutions that do a much better job than others in that area.

REPRESENTATIVE FEESE: Thank you.

CHAIRMAN PICCOLA: For the second time, Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. On that competition question that Mr. Feese just raised, is that -- I'm trying to understand the current or future possible makers of trusts versus the past already made whether it's 5 or 50 years ago trusts. Is that competition that you refer to applicable to both?

MS. ROGERS: I don't think I can give you an answer that's applicable in all cases. If a trust has a trust portability clause, it's certainly applicable to a trust that has been established in the past.

I think it is also somewhat applicable, and this may be contrary to the experience of others who have testified here, but I have been successful in having a corporate trustee resign, for example, in the face of pressure of extreme unhappiness from the beneficiaries and the threat of a removal proceeding. I think there is competition in that sense also. Certainly, for new business there is a lot of competition.

REPRESENTATIVE MANDERINO: Can I stop you right there; that ability to be successful in having the trustee resign. Are we talking about an example where there was a corporate trustee?

MS. ROGERS: Yes.

REPRESENTATIVE MANDERINO: Okay. I'm just making sure.

MS. ROGERS: That was a corporate trustee. There is certainly intense competition for new trusts today. The financial institutions, and more and more competing types of incorporated institutions are attempting to get into the trust business today. Brokerage funds are sitting up trust companies, subsidiaries and so on.

And the thing about trusts that already exists is that unless they're perpetual, charitable trusts they're going to end. They are not going to be around. It would be, I think, an imprudent business move on the part of the corporate trustee to count on new business if they really badly managed old business.

Frankly, there are financial institutions I would not encourage a client to name as a corporate trustee today, although I don't try to influence that decision, I will tell them if I know something bad. I think financial institutions are aware of that.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you, Ms. Rogers. You testify any longer you may have two clients here. Our next witness is Mr. James M. Edwards, a member of the McCune Foundation.

MR. EDWARDS: Thank you, Mr. Chairman. If you don't mind, I think it would be helpful for those participating if I could read through my comments. For one reason, they have changed a little bit from the distributed comments that were copied and sent around on advice of counsel in Pittsburgh. If I could just read through them, it won't take more than 10 minutes, and then I'd be glad to answer questions.

I'm 39 years old. I'm a resident of Pittsburgh, Pennsylvania. I was a banker 10 years with Union National Bank and later Integra Bank until 1990. When I left the employ of Integra to became a foundation manager, I'm involved with three family foundations and several institutions in Pittsburgh as trustee or incorporator.

As I said, I'm member of the distribution committee of McCune Foundation created by the will of Charles L. McCune, my great-uncle, who died in 1979. I have been a member since 1990. My father is the committee's chairman, and a first cousin of mine is the third and only other member of the committee.

Our duties under the Will include: selecting the charitable beneficiaries of the foundation and determining the terms and amount of the grants. Second, oversight responsibility to address breaches by the trustee of the prohibited transaction provisions of the Internal Revenue Code; and three, voting the stock of the corporate parent of the trustee held in the portfolio.

The Foundation established in 1979 has

a market value exceeding $300 million and makes grants exceeding $14 million per year, almost exclusively in western Pennsylvania. We make grants in the general categories of health care, education, social services, cultural and civic affairs, and economic and community development.

The sole trustee of the foundation is Integra Trust Company, a subsidiary of Integra Financial Corporation, successor to the Union National Bank. Charles McCune's younger brother was named as co-trustee, but he predeceased my great-uncle. This left Union National, now Integra, as the sole trustee.

In the period from July 1985 to November 1989, that's a four-year period, the trustee utilized over $15 million of the foundations assets to acquire additional securities of the trustee's parent, consisting of a debenture and common stock.

As a result of these purchases, the Foundation became minutely less than a 10 percent shareholder of the bank's parent corporation and had a total of 23 percent of its equity portfolio concentrated in the trustee's stock.

In 1991, we sought the appointment of family members as co-trustees in quiet conference and in exchanges of letters with the trustee, all to no avail. We petitioned the local court to have my uncle and myself appointed to the vacancy. The Court has ruled that there is a vacancy in the office of the individual trustee, but the bank trustee has reacted angerly with multiple acts of hostility, which has broken the relationship between our distribution committee and the trustee. As a result, the matter has become dormant and no individual trustee has been appointed.

In 1992, another family foundation in which I'm involved, which was able to be moved under the document's terms, we did move. Integra had been acting as trustee on this $80 million fund for approximately $200,000 a year as compensation. That year, a disinterested corporate trustee offered to perform this role for only $80,000 a year; a reduction of $120,000 a year. This was reason enough to move the trust, to save $120,000 a year for charity.

Given the long litany of other troubles in the larger foundation, it occurred to some of us concerned to ask a disinterested corporate trustee what it might charge as a fee on the larger McCune Foundation. Lo and behold, on a fund which had been paying over $350,000 a year for trustee services, they bid $180,000 a year. This amounts to savings of $170,000 a year which would go to charity. We petitioned to remove the trust to that corporate trustee partly on this basis, but again, to no avail.

To date, we have received no assistance from the Attorney General's Office which is expected to engage in oversight of these matters. In fact, the Attorney General has written that he considers the trustee's purchases of its own securities to be perfectly proper.

To date we have received no acceptable offers of settlement from this severely conflicted, sole corporate trustee; while to date, we have incurred over $500,000 in legal fees to enforce the provisions of the Will. And to date, the trustee has expended from the foundation's assets a similar sum to defend itself. This is money which is not available to the charitable beneficiaries.

My point in airing this tale is to help you conclude that the bill before you allowing portability of trusts under request of the beneficiary would have helped our problem by allowing a grossly conflicted trustee to be replaced without expensive court proceedings.

The banking industry is changing very fast, right out from under us. It is not inconceivable that before the year 2000, we will not have a Pennsylvania headquartered bank serving this Commonwealth's needs.

I do not believe that the grantors who placed their family's protection in the hands of local bankers considered this eventuality. The industry needs to benefit from the healthy competition which would result from your passage of Bill 326. That ends my prepared comments.

CHAIRMAN PICCOLA: Thank you, Mr. Edwards. Just a point of clarification. Under both of the trusts that I believe you referred to, and you referred to two of them with specificity, they were both charitable trust?

MR. EDWARDS: Both charitable trusts. The smaller one is perpetual and it's for the benefit of the citizens of New Mexico. The larger one has a 50-year life described in the terms of the document and we're about in year 15 of the 50 years. It will terminate.

CHAIRMAN PICCOLA: And the smaller one had a removal clause in it which was used?

MR. EDWARDS: Yes, it did.

CHAIRMAN PICCOLA: Okay. The larger one did not?

MR. EDWARDS: Does not have a clause for removal.

CHAIRMAN PICCOLA: But it is a limited trust in terms of time?

MR. EDWARDS: Correct.

CHAIRMAN PICCOLA: Do you believe there was some connection between the fact that it does not have a removal clause and that it is a limited trust in terms of time?

MR. EDWARDS: I don't know that.

CHAIRMAN PICCOLA: You don't know that one way or the other?

MR. EDWARDS: No.

CHAIRMAN PICCOLA: Under the terms of this bill that we are considering today, 326, who would be considered the beneficiaries entitled to cast ballots in a removal action?

MR. EDWARDS: I don't know that. I recognize it's not easy to describe who the beneficiaries are in this circumstance of a charitable trust where there are multiple beneficiaries. I'm not sure that the bill would help in our specific instance, except to create a climate of accountability in the corporate trustees. In a situation such as ours and in the situations described this morning.

CHAIRMAN PICCOLA: Representative Manderino informed me at side bar it's her understanding, and I'm sure she'll want to ask some questions, that under the circumstances of a charitable trust that the Attorney General would be entitled to cast the votes.

If that is in fact the provisions of House Bill 326, how do you believe that would favorably or unfavorably impact on the circumstances that you related?

MR. EDWARDS: It's been my opinion that the oversight of the Attorney General has been no help to us in our request to save money for charity in this charitable instance.

CHAIRMAN PICCOLA: Other members of the committee have questions. Representative

Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. I will double check that point. I'm not sure that's accurate, but that's my recollection about the Attorney General.

In your testimony about the McCune Foundation, you talked about, we petitioned to remove the trust partly on basis of fee but to no avail. Now, does that mean you have instituted formal legal action and there has been no definitive decision, or are you just waiting to hear?

MR. EDWARDS: There's no definitive decision. That action was instituted, I believe, on August of 1992, and we're still in discovery in those proceedings.

REPRESENTATIVE MANDERINO: Also when you say to date the trustee has expended from the foundation's assets a similar fund in defense as you did --

MR. EDWARDS: Similar fee.

REPRESENTATIVE MANDERINO: Similar fee, excuse me. If I understood people's prior testimony, what you're saying is that money has been spent. That money has been spent and charged against the foundation so that that money is not available for giving and maybe at the end, depending on what the Court decides, you may or may not get some of that back?

MR. EDWARDS: There's a possibility of recovery of those fees at the ultimate resolution of this, either by settlement or by court action.

REPRESENTATIVE MANDERINO: Okay, but that's an uncertainty at this point?

MR. EDWARDS: Correct. To date the fees are kept current monthly to the firm defending the trustee. We family members prosecuting in this case take up a collection as needed to keep our lawyers paid.

REPRESENTATIVE MANDERINO: Okay, but the current defense costs, are they to be charged in the future should we win against the foundation or are they currently being charged?

MR. EDWARDS: They're being paid. They're in the lawyer's pockets.

REPRESENTATIVE MANDERINO: Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you Mr. Edwards. We appreciate your testimony.

MR. EDWARDS: Thank you.

CHAIRMAN PICCOLA: Our next witnesses are a panel of two, Richard H. Brown, Executive Vice President of York Bank and Trust Company, and Louis J. Sozio, Vice President of PNC Bank. I believe they are here representing the bank association.

MR. BROWN: Good morning. My name is Dick Brown. I chair the Trust Legislative Committee of the Pennsylvania Bankers Association. I am also the Executive Vice President of the York Bank and Trust Company in York. With me today is Lou Sozio of PNC Bank in Philadelphia. We very much appreciate this opportunity to bring to you our sense of fairness and the position of the Pennsylvania Bankers Association on this matter before you today.

As the state bank trade association in Pennsylvania, PBA represents approximately 250 commercial and savings institutions ranging from the smallest to the largest in the Commonwealth. PBA represents 99 percent of the commercial banking assets in this state. The PBA's legislative policies are recommended by committees of specialists, such as the committee which I chair which focuses exclusively upon legislation and regulations which affect trust and estate administration.

The PBA's legislative policies are determined by its state government relations policy committee which consists of bank chief executive officers and senior managers from member institutions of all sizes in a variety of locations throughout the Commonwealth. I also sit on that committee.

These committees work very hard to review assigned legislation. We carefully consider the impact of the bills not only from the perspective of the banking industry, but from the perspective of the customers and communities we serve as well as the broader, public policy perspective.

Fiduciary replacement legislation, such as the bill before you today, is one of the issues which PBA has examined most closely. In the interest of time, I will not repeat the number of instances where this type of legislation has been proposed in the past. I'm sure you are aware of that. It is in our prepared testimony.

The proponent of this bill, the HEIRS Organization, has revised its technical provisions markedly over the years. These changes have not affected the PBA's view of this legislation. We remain adamantly opposed. Our opposition is based on the fact that the proposal ignores centuries of common and statutory law. It's enactment would do a grave disservice to the Pennsylvania's citizens and their estate plans. We respectfully urge you to take the same position for these reasons which Mr. Sozio and I will more fully outline for you today.

There has been a great deal of trust education which has come out this morning. I will opt to skim some of the facts that we have in our written testimony. I frankly am impressed by the knowledge of this committee.

Moving into what is the trustee's responsibility, however, in general, trustees have duties to collect and safeguard assets, provide a particular definite disposition of assets on an ongoing basis that cannot be changed absent extraordinary circumstances, collect income, keep records and make reports and make distributions in accordance with the trust instrument.

The trustee may have the ability to make discretionary distributions which we've referred to as, sprinkle income among a class of beneficiaries or use principal for the reasons that may be specified by the trustor.

However, Pennsylvania law is clear that the trustee is duty bound to decline a beneficiary's request for more income or an allocation of trust principal inconsistent with the provisions of the trust document and the trustee's interpretation of the trustor's intent. Such a situation creates an inherent conflict between trustees and income beneficiaries.

Why do trustors select banks in the first place to manage trusts? Banks and other corporate fiduciaries are often selected as trustees because they can provide flexible, sophisticated asset management expertise that individual trustees often cannot. This is because corporate fiduciaries have employees on their staff with very specialized skills.

Banks also provide security to trustors for a variety of reasons, most of which are due to the fact that the banking industry is one of the most highly-regulated industries in America. Banks are currently subject to regulation by at least two federal regulatory agencies, and many face regulatory oversight and intervention by several more, including state bank supervisors.

This regulatory oversight requires banks to maintain extensive internal compliance and auditing functions to reduce their customers and the FDIC's funds exposure to loss. Banks are well-capitalized and typically maintain extensive liability insurance coverage.

Individual trustees, on the other hand, generally are not subject to much regulatory oversight, if any, and lack capital adequacy which corporate fiduciaries must maintain. These are merely factual distinctions which PBA notes only because House Bill 326 would address both corporate and individual fiduciaries. Banks generally accept a sharing of responsibility with individual co-trustees if that is the trustor's wish.

Perhaps, the overriding reason banks are so often chosen by trustors is that they are perpetually objective and independent. Because they are institutions, even though they are staffed by individuals like Mr. Sozio and me, they are capable of a degree of objectivity that an individual trustee simply cannot achieve.

The proponents of this legislation seem to target banks in their campaign. PBA views this legislation as much broader than an attack on the banking industry, we view it as an attack on individual trustors and their counsel. The proponents would have the committee conclude that so much has changed in the banking industry that trustors' selection of particular bank trustees should be drawn into question.

PBA would like you to know that trust services provided by the banking industry have improved greatly over recent years due to advances in technology and the enhanced asset management capability that technology enables.

I would just like to insert at this point that there's been significant discussion on the competitive aspects of remaining in business. I suppose by inference that competition does not exist because of the inability to move.

I cannot speak for the industry as a whole, but I believe I'm pretty comfortable in making this statement; that probably less than 15 percent of the gross revenue of a typical trust department, certainly it's the case in our organization, comes from the kind of trusts that are being addressed by this type of legislation. In effect, we must compete. We must compete very aggressively and not just by price, but by quality of service to enable us to attract all types of business to our department.

Our core business is investment management. I would submit that the level of expertise and performance of the banking industry, while it certainly varies from institution to institution in any particular short time frame, that over time the management of the banking industry in the trust area has indeed been very prudent and very good. Otherwise, we would not be building the lines of business that we do in addition to this type of relationship.

You've already heard how Pennsylvania

Appellate Courts have addressed fiduciary responsibility. I would just point out that the Pennsylvania Supreme Court has held that removal is an extreme form of relief which should only be granted where the trust estate is actually endangered and intervention is necessary to save trust property.

Again, you heard very excellent testimony from individuals who are attorneys and are much better versed than I am on current Pennsylvania law. I would move through that part of my testimony.

I would just emphasize the fact, however, and I'm pleased as Representative Manderino asked the question of clarifying the difference between fraudulent and neglect reasons for removal. I think that is a very significant point to have clarified. But indeed, I would further add to previous testimony that in cases where a working relationship has been severely undermined for whatever reasons, one thing banks don't like is adverse publicity.

Frankly, if a relationship has became significantly distressed for whatever reason, so long as the bank can determine that it is not in keeping with -- it is not jeopardizing the trustor's original request in entering into the trust, more often than not a bank fiduciary will take steps to avoid such a confrontation if it can do so. It will typically do so with court approval.

Why is the PBA against legislation which the proponents couch as merely providing trust portability? This legislation would do much more than merely provide portability. Any attempt to categorize it so simply or to call it trust reform is simply disingenuous.

Portability sounds nice and PBA acknowledges that shifting a trust from one fiduciary's management to another is sometimes indicated. The fact is that portability is already fully possible under the current Pennsylvania fiduciary performance standards and the statutes governing trusts.

First of all, a trustor is free subject to certain tax law constraints to provide for successor trustees and the circumstances under which they may be empowered. As an alternative, an individual who merely seeks tax shelter and limited liability for his or her progeny could consider establishing an outright limited partnership to govern his or her assets with the limited partners, i.e., beneficiaries, granted the right to vote the general partner out of office. Frankly, that is not usually what the trustor wants to do.

Second, portability implies that freedom to change trustees is necessarily good. Freedom to change the trustee at the whim of the current income beneficiaries is often exactly what the trustor wished to draft against. The trustor would not have established a trust in the first place if he or she wished to substitute the desires of the beneficiaries or their spouses, friends and others who may seek to influence them for the trustor's own legacy plan.

Let's not forget the purchaser of the trust services, the one to whom the fiduciary owes its first duty is the trustor; not the beneficiary. Trustors are often able to see in their progeny characteristics that those heirs do not or cannot acknowledge. Many of yesterdays and today's trust customers are self-made individuals who amassed their fortunes through old-fashioned hard work. If they wanted to hand that wealth directly to their heirs they could, but they have chosen not to for a variety of reasons.

Some of those reasons are obvious, such as the fact that they may prefer that their children and grandchildren work for their basic living, with trust income only as an additional support for specified needs or emergencies, with the remainder eventually designated for other family members or a favorite charitable cause.

Trustors may be guarding against their heirs' use of accumulated wealth to fund devastating addictions or other behavior that is not desirable.

An examination of each of the new criteria proposed by the HEIRS group demonstrates how their application could completely change the controlling trust law of Pennsylvania and subvert the intent of trustors.

The proposal would add a new paragraph, 7122, which would substitute the judgment of the current beneficiaries of a trust for that of the Orphans' Court. You've already heard the discussion of the unequal waiting of the income in residual beneficiaries. And, of course, we've heard conversation that could be addressed, altered and changed if that's what it basically took to have this legislation approved.

The appointed special trustee contemplated by the proposal would make his or her removal decision based upon very nebulous and unmeasurable criteria. These three have been itemized before. But they are: Basically the working relationship between the trustee and the petitioners has became sufficiently impaired; trustee compensation is sufficiently excessive; and administrative or investment performance has been sufficiently substandard.

On an aside, I'm not sure how long it would take to develop appropriate case law on any of these issues which also by definition will be moving targets forever. I think that would be extremely difficult to attach appropriate case law to these reasons.

Why do we find the current proposal so objectionable? Current law rests its protection on the principle of allowing a donor to condition his or her bounty as suits himself as long as he violates no law in doing so. This longstanding and central principle of Pennsylvania law would be reversed by enactment of the proposed legislation. Let's examine each of the bill's criteria more closely.

The working relationship between the trustee and the petitioners has become sufficiently impaired. This criterion of the proposed statute would subordinate the primary relationship between the fiduciary and the trustor to the relationship between the trustor and the petitioners. Trustees are duty-bound to carry out the wishes of a trustor, and those wishes might not please the beneficiaries.

Again, I'll skip through some of this because we've had some discussion on some of those reasons. But, I could also state for you and we have opted not to, any of us that have been in the trust business for any period of time -- I've been in for 27 years and Lou 29 years.

Interestingly, Lou is with PNC who has continued to be a survivor in the interesting merger activity that's taking place in banking.

I'm with the same organization that I have been with for 27 years in the trust business. We've had three different parents through that period, but I would just comment that we remain very dedicated to the servicing of our local community.

The second rational: Trustee compensation is sufficiently excessive. This nebulous standards should not be allowed to replace the considered and well-reasoned fiduciary compensation standards which are currently the law in Pennsylvania. In addition, the mandatory exclusive jurisdiction of the Pennsylvania Orphans' Courts over the issue of reasonable trustee compensation should not be delegated to an appointed individual.

Current law provides that fiduciary compensation is tested by a combination of factors including the labor involved, risks and responsibilities incurred, the results achieved for trustors or beneficiaries and prevailing market rates. It is not a simple black and white issue of this fee for this trust, or any trust. The services vary significantly among trusts.

The third one: Administrative or investment performance has been sufficiently substandard. As noted above, Pennsylvania law currently grants the Orphans' Court the power to remove and replace a fiduciary when there is a waste or mismanagement of the estate or its interests are otherwise jeopardized.

The substitution of a vague standard such as this would be a serious public policy mistake, one which I would suggest would encourage individuals to seek a perceived better rate of return; many times, just at the time that that new investment organization or entity is about to suffer the downturn in the cycle for its particular style.

The current fiduciary investment standard in Pennsylvania is the prudent person rule, which requires the fiduciary to make investment decisions in the manner in which a prudent person would if managing his or her own funds. This standard has always been viewed as risk-averse and conservative.

Pennsylvania will soon be faced with a decision whether to adopt uniform legislation which would cause a change in this investment standard to a prudent investor standard which judges a fiduciary's investment performance under modern portfolio investment theories which allow the trustee to determine the risk and return objectives reasonably suited to a trust as if the trust were a separate entity, rather than a combination of relationships with multiple beneficiaries with potentially differing interests.

PBA believes that the issue of fiduciary investment standards and performance should not be addressed in the context of fiduciary replacement legislation supported by individual beneficiaries with their own agenda which may be in conflict with that of the trustor, but instead should be left to the day when the broad issue of fiduciary investment standards can be considered in light of a new uniform statute which has the recommendation of the National Conference of Commissioners on Uniform State Laws. It is dubbed the Uniform Prudent Investor Act.

Another objectionable aspect of the fiduciary replacement legislation is its provision which would disable corporate trustees from even arguing that the testator's intent was being subverted by its removal merely if ownership of the corporate trustee or its management had changed subsequent to the trust's creation. This is absurd.

Given that many trustors establish trust with the intent of their existing for long periods of time, the mere changeover in personnel at a financial institution should not determine whether it is time to replace the institution selected by the trustor.

I would not sit here before you today and suggest that there are not different levels of service provided by different institutions. Certainly there are. None of us would deny that.

But, I would say that again, keeping in mind that competitively the vast majority of a trust division's revenue is obtained from account relationships that are totally portable, meaning within a letter of notice the individual may move that relationship, I would submit that there is ample competitive pressure to keep institutions very competitive over a reasonable period of time.

The most objectionable aspect of proposed legislation is that, it would apply to trusts created long before its effective date, including those deceased trustors barring ability to amend their trusts to include a specific directive that the trustee shall not be changed.

In conclusion, more than adequate protection is available under current law to redress actual cases of fiduciary neglect of the interests of beneficiaries. As pointed out earlier, trustors have always had the option of naming a successor trustee who would assume the trust under specified circumstances.

This legislation would enact complicated statutory burdens. It would undermine the right of individuals to provide protection of their legacies for the uses they ultimately intend. It would create a causeless cause of action and encourage needless litigation for which there is no judicial precedent.

It would most certainly invite disputes among families which the already-overburdened courts are not equipped to manage under the nebulous standards outlined in this bill. It would eradicate 200 years of well-developed case law and remove authority from the expert Orphans' Courts and hand it to individuals.

The end result of this legislation may well be to drive trustors to site their trusts, and their wealth I might add, in states other than Pennsylvania. The PBA certainly sees no public policy benefit in that relocation of wealth and businesses.

This concludes our formal testimony. Mr. Sozio and I would be happy to respond to questions.

CHAIRMAN PICCOLA: Thank you, Mr. Brown, Mr. Sozio. Do members of the committee have questions? Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. I want to ask some hard questions because Mr. Sozio represents my bank, I feel that I have the ability to do this.

One of the things that was mentioned, Mr. Brown, in your testimony was that the banking industry is one of the most regulated industries in America. Taking that as the premise, for example, in Pennsylvania I know that we regulate the maximum amount of interest that you can charge on a bank credit card, correct?

MR. BROWN: That's correct.

REPRESENTATIVE MANDERINO: We do not at this point in Pennsylvania regulate fees that are associated with, for example, a checking account?

MR. BROWN: Being a trust banker, I would have to say no.

REPRESENTATIVE MANDERINO: Okay. Do you know, Mr. Sozio?

MR. SOZIO: I think that's right. You're right.

REPRESENTATIVE MANDERINO: We do not regulate these?

MR. SOZIO: Right.

REPRESENTATIVE MANDERINO: We also do not regulate or set any maximum fees that can be placed on trusts or trust accounts, correct?

MR. SOZIO: That's correct.

REPRESENTATIVE MANDERINO: Okay. I'm sure that you're not prepared to answer today, but I would be interested, because I don't want to presume that I already know the answer, as to what the PBA's position on regulating maximum fees in the area of trusts would be. I would be interested in that opinion.

MR. SOZIO: I'd like to comment on that if I could. The general trend in most states, I think New York if you take that into consideration; new Jersey is to follow the Pennsylvania rule which has been reasonableness. Both New Jersey and New York, if my recollection is correct, had statutory rates and have gone to the reasonable standard.

REPRESENTATIVE MANDERINO: Who determines reasonableness under that standard?

MR. SOZIO: Orphans' Court. And I should also add, each one of the trustors when we make a presentation, we have full-blown glossies of each one of our scheduled rates, for each one of our products going from a custody account, a management account, trust and estate. We don't hide these. They are part of our presentation packages. They're put in the packages.

REPRESENTATIVE MANDERINO: One of the areas that very much bothers me is, you may have guessed by some of my questioning of prior people who testified, is the issue of the trustee's ability to defend against an action for potential removal by using the assets of the trust.

It seems to me that a fairer playing ground would be that after all is said and done, the Court could determine where appropriate attorney fees lie as in most other civil litigation. For example, today if I bring a civil lawsuit against somebody for whatever reason, the Court may assess attorney fees against me if I was wrong, but that's being done after the fact and not during the course of the litigation.

Does the PBA have a position, or I would be interested in knowing what the PBA's position is on a change in law that would not allow a use of trust assets during the course and before a final determination on removal?

MR. SOZIO: I don't know what PBA's position is. I can tell you what PNC and the predecessor Provident is. We never charged counsel fees until such time as the matter had been resolved. At that time we either request or petition the Court for permission to charge the account if we were successful. In one matter we were unsuccessful, it came out of our pockets.

REPRESENTATIVE MANDERINO: Can I take that that is still current practice today for your bank at least?

MR. SOZIO: For our bank, I think it is current practice.

REPRESENTATIVE MANDERINO: Can I take by inference from what you just said is that in all the cases that were litigated against you, you only lost one?

MR. SOZIO: No.

REPRESENTATIVE MANDERINO: Finally, I always like to try to solve something practically if we can't do nothing else by today. I'm throwing this out not as a question, but by way of suggestion. But it seemed to me from a lot of -- the bulk of your testimony today again dealt with the issue of the wishes of the settlor or creator of the trust whose wishes can no longer be determined because he or she is no longer with us.

So from that perspective, I won't

mention the name of the bank on tape because I don't know that Mr. Staszak did. If he did it's on the record; and if he didn't I won't mention it.

I would certainly hope that the members of the bank and community would talk with him after this hearing so that we can figure out why a settlor who is still living, whose intentions seem to be fairly clearly known have been waiting since 1992 to make a move, whose intentions seem very clear. Certainly, with all the brain power in the room, we can figure out and solve that one today. Thank you.

CHAIRMAN PICCOLA: Representative Feese.

REPRESENTATIVE FEESE: Thanks, Mr. Chairman. Gentlemen, I apologize. I wasn't here for all of your testimony. I have two questions. On page 3 of the testimony it refers to how Pennsylvania Appellate Courts have addressed fiduciary responsibility. The testimony indicates that Pennsylvania Supreme Court has held that removal is an extreme form of relief only granted when the estate's actually endangered and intervention is necessary to save trust property.

Could either of you gentlemen help me? Was that a decision where the Court was interpreting the statute, Pennsylvania statute for removal and that was the basis of the language, or is this some common law principle that the Court enunciated? Do you have any idea?

MR. SOZIO: I'm sorry. I don't have any idea.

REPRESENTATIVE FEESE: More importantly, can you tell me what public policy reasons there would be for preventing a trust from being moved from bank A to bank B, if bank B will charge a lower fee and at least over the last 5 years or whatever has a better track record as far as their return on their investments? What public policy reason should say, no, we shouldn't allow that to happen?

MR. BROWN: Well, public policy reasons come back again I think to the crux of the relationship between the individual that chose to make a decision to have his or her assets handled in a way and by an institution that had he or she wanted to do. That is that individual's right to do that.

Some of us, sometimes we joke frankly in the industry about, and there are well-documented indexes that then would suggest that the casual investor, the casual investor makes the absolute wrong decisions at the absolute wrong time with regard to investment performance.

I think there could be a significant public policy issue with those rights being given to individuals who conceivably were not -- the trustor did not feel he was in a position to be making those kinds of decisions, possibly.

I believe that the most serious public policy issue in my mind is the breaching of that trustor's right to have his funds handled the way he wanted them handled.

REPRESENTATIVE FEESE: Let's --

MR. SOZIO: Can I make a further comment? Up until a few years ago, it was a genuine concern on at least our part that the IRS could rule unfavorably if income beneficiaries were able to move trust assets from one bank to another bank. It was a real genuine concern, not only by bankers like myself, but a good group of lawyers that the IRS could in fact say, income beneficiaries have control; therefore, the funds are now taxable.

That has changed over the recent past. In fact, one of my competitors in Pennsylvania, whose name I won't mention, has recently got the IRS to favorably rule on their portability language. But in the '80's that was a genuine concern; that if a beneficiary came to you, an income beneficiary, and we would agree to move it, we could, in fact, impact that trust unfavorably as to taxation.

REPRESENTATIVE FEESE: Expanding upon what you indicated, Mr. Brown, and I'm not thinking in context of House Bill 326, because I have serious reservations about aspects of that. But, in just general context of what we're trying to achieve, if the public policy reason is settlor's intent, I'm assuming the settlor's intent has two aspects; one, a civilized aspect, obviously with intent of trust documents, but maximizing the income or residual for the beneficiary, whatever the case may be.

If the financial institution is not doing that or if another financial institution, I should say, could do it better, then at least one aspect of the settlor's intent isn't there. And if a financial institution that the settlor originally chose has changed so much through the years, and that's because banking industry evolved -- and I believe people pick a trustee, a particular bank because the people they know that are there are then. I mean, that's part of why you go out and market.

Isn't the settlor's intent forwarded anyway? The bank has changed, for example, I used this earlier when I was talking to the Chairman here that my hometown is a town called Montoursville was the First National Bank of Montoursville owned locally. Then it became the Bank of Central Pennsylvania; then was bought by Commonwealth Bank, which is now Meridian. I don't know where my mortgage payment goes anymore. I just throw it in the mail slot.

But when that occurs and you have a bank that's not performing maybe as well as another bank and the institution has been transformed to some other institution, how are we forwarding the settlor's intent by going somewhere else to achieve greater income if the income beneficiaries are higher residuary, greater residuary assets for the remainder? Should we be able to do that?

MR. SOZIO: Once again, I don't think we have any objection to portability. I think we have an objection to the way portability that's presented in House Bill 326. At the same time, PNC, my bank, I've been with it for 29 years. I come from a small town in northeast Pennsylvania.

I think and I don't want to pick on small banks and I'm certainly not here to pick on small banks, but the ability to deliver a product to the larger organization, if we look at what PNC is currently able to deliver, okay, in terms of its asset management, we have over $200 billion in either discretionary or nondiscretionary funds.

We have a huge asset management group. We are able to deliver to our small community banks that we took over, expertise that was never available in those smaller towns. If we're carrying out the trustor's purpose, I think we can do it better today than we've ever done.

The ability, nothing happens to the ability of a bank simply by changing its name. There is recourse within the courts for anything of an egregious nature, but simply because there are mergers, consolidations, acquisitions, I don't think that's a reason that the trustor's purpose be --

REPRESENTATIVE FEESE: No, not necessarily, but if the public policy reason that we're speaking of is the settlor's intent, and that intent was based on some prior relationships, to me that's not so much of a factor anymore as much as it is making sure the assets are maximized.

And just as a comment, I don't believe that House Bill 326 is the vehicle. I think it gives too much control to the beneficiaries in making that decision in consulting that special trustee. But I am concerned there isn't more portability. I think some way there might be a vehicle to interject just a little bit of competition. I don't know if the banks of my firm I represent agree, but that's at least what I think. Thank you.

CHAIRMAN PICCOLA: Thank you,

gentlemen, for your testimony. Amazingly, we're right on time, and our last witness for today is David Rawson, attorney, and he is employed by or represents Main Line Trust Company.

MR. RAWSON: Thank you, Mr. Chairman. I'm the President of Main Line Trust Company. I brought some prepared remarks which I would like to go through with you briefly. I'd like to make a few comments on what some of the other speakers have said today. Then I will be very happy to answer any and all questions. I'm sorry our group shrunk to be so small, but I think that we have dwindled down to the best members of all. Thank you for sticking around.

I come before you with 27 years of experience in the trust business, having both a legal and business degree background. I have worked in both large trust departments and a small trust company and watched the evolution of the business in response to unforeseeable, revolutionary changes in banking laws that began around 1980.

Prior to that time, the local banks that controlled the local trust business were under local mangement, boards of directors and shareholders who knew that if trust customers were not given the best service, the right people would hear about it promptly.

Since 1980, we have seen local controlled banks slip away to other cities and other states through mergers and acquisition at an accelerating pace. Trust customers have consequently lost the ability to insure the same level of responsiveness to their concerns.

I don't mean to suggest that the new owners and managers don't try to give any service, because they could always be sued if the service fell below a basic legal minimum, but the new owners and managers are driven primarily by far-flung bottom line considerations, and it is no secret that lending money successfully to larger and larger interstate markets is a far more financially remunerative endeavor than nursing along a labor intensive, low-profit margin personal trust business.

Trust departments often don't have the political clout within their own banks to get what their customers need in the priority for resources against more profitable departments.

The single factor that is the most harmful to the public and the most needing of reform is the lack of continuing competition in the trust business. Once an irrevocable trust has been set up at a bank, the rules of trusts make it nearly impossible to move the trust, barring the most egregious malfeasance.

So when granddad set up a trust at Girard in 1951, thinking that a century-old local institution would treat his heirs no differently than it treated him, he would be very much surprised to find out, if he could come back, that the Girard no longer exists; the trust headquarters has since been moved to Pittsburgh, and more recently to Boston, and that only a handful of Philadelphia employees have survived the purges and staff turnovers of the past 10 years.

In other words, the nature of the trustee he chose has been totally overturned, and his family under trust law of legal fiduciary successorships is locked in with no recourse under the normal rules of free competition.

As many say, you can change your

broker or lawyer or even your spouse more easily than you can change a bank granddad unwittingly locked you into before you were born. This is not good public policy. No industry should be shielded from the daylight of the free market.

I am not here to discuss the specific merits of H.B. 326. It contains some provisions which I feel go farther than we need. But, I trust the legislative process to grind off some of the rough edges, and feel that a few details should not stand in the way of the momentum of desperately needed reform.

The entrenched providers of trust services don't want to see free competition as to price for service. They want to preserve unilateral fee escalator clauses to jump up their fees with no recourse for their customers. They don't want to have to hire more experience and expensive personnel to furnish more than the cheapest minimum acceptable level of service.

Again I stress, I am sure they do this not from malevolence, but from the inexorable corporate pressure to create current profits at the expense of defenseless beneficiaries.

Finally, let us face the political

Finally, let us face the political question directly. Is this reform only for the rich and not of concern to the average middle-class voter?

Well, the average trust produces less income than Social Security. You or I or anyone else can be helped by reform. Even the banks themselves, who will begin to see more business on their books once the public no longer feels that the family loses all control once the big bank gets into the picture.

Please keep the reform balance rolling. It will be good for the trust industry in this Commonwealth, as well as the public. That is the end of my prepared remarks.

CHAIRMAN PICCOLA: Thank you, Mr. Rawson. Were you present when Ms. Rogers testified?

MR. RAWSON: She was the lawyer, I believe, in Harrisburg?

CHAIRMAN PICCOLA: Yes.

MR. RAWSON: Yes, I was.

CHAIRMAN PICCOLA: I believe during the course of her testimony she referenced her experience in her practice that more and more of particularly bank trustees.

Would you concur with that and would you also concur that that is a form of market pressure that is driving what we would characterize I guess as trust business into other areas outside of the large banks?

MR. RAWSON: That is correct. As a matter of fact, I can tell you I personally participated over a number of years in a survey we once did at the Girard, which showed that in the Philadelphia area, we actually went to the courthouses and logged in the total number of Wills probated, how many named banks as fiduciaries and how many did not.

We can tell you that for trust estates of a hundred thousand or more, in the 1960's the professional trust providers got 20 percent of the appointments, and by the mid 1980's they got only 5 or 6 percent. The public has been voting with its feet away from this industry.

I'm convinced that although there may be some short-term changing of trusts around, it would be very good for the industry, for the public to perceive that the banks are as good as they are and collectively exposed to competitive they are and collectively exposed to competitive pressures, people won't be afraid to name banks anymore. I think they're very short-sided to oppose this legislation.

CHAIRMAN PICCOLA: But the trend, or the perceived problem I guess that this legislation is attempting to remedy from your own statistics is apparently being remedied by the manner in which people are choosing their trustees as they do their estate planning. Maybe we are being a little presumptuous in pushing legislation like this. Maybe the people out there are really smarter than they give them a lot of credit for.

MR. RAWSON: As a person committed to the trust industry, as someone who spent 27 years of his career in this industry, I am convinced that banks do an excellent job, a far better job than lawyers without the assistance of a bank, investment advisors without the assistance of a bank, and individuals without the assistance of a bank, too.

The problem is, the banks have not put their best foot forward. They have frightened their market away. Legislation like this should help everybody.

CHAIRMAN PICCOLA: Thank you.

MR. RAWSON: Mr. Chairman, I have a few more comments to make.

CHAIRMAN PICCOLA: I didn't mean to cut you off. I thought you were done.

MR. RAWSON: That's quite all right. I wanted to address some of the remarks that were made earlier today because I think they deserve to be put in a little context.

For example, we spent a little bit of time talking about reasons why people set up trusts. I can tell you from my perspective having dealt with many trusts that were set up back in the teens and the '20's, right up through today, I help people set up trusts every day in my practice.

Originally, there was a dynastic urge. The patriarch didn't trust all these children and grandchildren with the money and he wanted to preserve a certain pecking order or a certain control. Many trusts in the old days were set up that way. They didn't trust the kids.

I would say probably in the '50's that changed into much more tax driven reasons. I would say that the average trust in that period was driven much more to get advantage of marital deductions, various front-end or rear-end charitable arrangements; generation skipping which when it was completely legal and there was no $1 million cap as it now is. This was the pure era of tax avoidance.

Oh, sure, there was always some situations where there was good reason not to trust the kids. Somebody did have a disability of some sort. Somebody did not have good judgment. Sometimes the father frankly didn't like the son, and there were just family problems.

I found that more recently there is less of a tax motivation now and far less of this nontrusting of the children. As American society becomes more mobile, as more and more people take command of their own life's decisions, I find that a new reason now is protection from creditors. In this day of very common divorce, in this day of great litigiousness, trusts are marvelous ways of protecting your children from all sorts of unforeseen problems; children who are very intelligent.

It's interesting, you know, I think people were drawing an incorrect assumption before that the trusts only serve wealthy people to pass it on. Oftentimes, it is the less wealthy father that's leaving it to a very wealthy son who says, look, Dad, I have plenty of money of my own, but I'd like to have the income from the trust; not have it taxed in my estate when I die, and then make it available for grandchildren's education or great grandchildren. So sometimes you have a reverse in the order as to why the trust is set up.

All of this is being said because, the general theory that, which I certainly buy into, that people have the right to dispose of their money by will or trust as a constitutional right and their choices as enumerated in those instruments should be respected. But we have to look at what their real choices now are. Is this an understanding with the kids? This is a cooperative arrangement to save taxes, to protect the family patrimony.

Unfortunately, far too many of these trusts have been set up without the lawyer telling the client, by the way, you mentioned to me that you have your checking account at XYZ bank so I guess you'll want to have trust there forever. Without saying, oh, but by the way, banks do change. By the way, your kids may move away.

I suggest that we put in a clause specifically giving an independent trustee or some group of family members the right to change the trustee as the family circumstances change.

What I'm suggesting is that most pre-existing documents and even many of them now, unless you have a knowledgeable lawyer or a very knowledgeable client who knows that this can be drafted into the document, doesn't know that these protections can be put there. Therefore, by statute I think it's terribly important we do the minimum.

For example, we talked about Section 1608, which allows the portability of a trust out of an institution that has been recently acquired, I think it's like within 90 days. Well, how can you tell within 90 days the new owner of the institution is going to service your trust well? At the very least you should extend that to 5 years or something.

Let the people say, you know, this isn't the same bank that granddad said was trustworthy. He'd be spinning in his grave if he knew what's happened to the people he trusted. We have to find a way to honor changing circumstances, and I'm convinced it will help the trust companies in long run.

I specifically also wanted to address myself to the question about the grounds of moving a trust from one institution to another. We talked about Section 7121, which gives wasting and gross mismanagement and one person said, you know, well, gee, we have to -- it's so easy to do it. You just take it to a court. Then the other one said yes, but the Supreme Court says gross mismanagement has got to be pretty bad to move it. You're arguing both ends against each together.

The current law, unfortunately, does not allow the moving of a trust except in the most egregious of malfeasance, as I mentioned before, unless you are willing to spend a tremendous amount of your own private money because you do not get your expenses reimbursed.

Traditionally the trustee can continue to sit there, get all his expenses covered throughout whatever litigation unless somebody upsets that at the very last moment because, indeed, they can prove it was egregious malfeasance.

But the poor family that probably needs a little more income now is trying to build up the family trust is financially strapped and have to go and get their own private sources, knowing that the Pennsylvania Supreme Court said that moving a trustee is an extreme remedy. We need this legislation to loosen it up, the Court system and the evolution of the rules of trust that prevented this from being the kind of procedure that we ought to have under today's circumstances.

Last thing I want to particularly mention is unilateral escalator clauses. Just for the record, most trusts are under what the banks call standard fee agreements, which say that we can unilaterally change our rates whenever we want from now until the end of time.

I think this is dreadful as far as public policy. How could granddad possibly know that what he was signing when he just signed a standard fee agreement had a little clause in there saying, that whenever this bank wants to raise its rates every year, regardless of how much the portfolio's appreciated and how much their bigger percentage that's yielding under its old rates, the bank can just raise them and raises them and raise them, and there is no appeal from this unless it's so egregious that you go to the Supreme Court and possibly persuade them of it.

I can tell you, 30 years ago banks raised their standard rate once every 10 years. Many banks now do it every other year or even every year. There is no recourse for the public when they are dealing with unilateral escalated clauses. This must be banned. This is against public policy.

As far as the actual text of House Bill 326, I agree with many of the speakers today. It has its shortcomings. I had drafted other things which I am not at this point going to put forth because this is the proponents of H.B. 326 day. But, we can hit the real things that are screaming for reform very well with something a little less than H.B. 326.

I urge you, please, to help our industry and to help our public get something going here while we've got momentum. Thank you.

CHAIRMAN PICCOLA: Representative Manderino.

REPRESENTATIVE MANDERINO: Thank you, Mr. Chairman. Mr. Rawson, if you know this, I just want to double check presumption I'm about to make before I make it. My recollection is that Pennsylvania or Pennsylvania banks, I'm not sure which way to say it, is either the highest or one of the highest in terms of -- let me rephrase that.

In Pennsylvania, we have probably the largest or one of the largest--I don't know what the right word is--corpus of trust funds here in our state today than in practically any other state in United States. Am I correct on that assumption?

MR. RAWSON: Yes, you are.

REPRESENTATIVE MANDERINO: Okay, so when we were talking -- so that means there are lots and lots of trusts established here in Pennsylvania --

MR. RAWSON: Correct.

REPRESENTATIVE MANDERINO: -- historically and to this date?

MR. RAWSON: Correct.

REPRESENTATIVE MANDERINO: What you talked about with regard to your research and what Representative Piccola questioned you about, about, isn't the marketplace kind of acting already because, look, your own statistics show that only 5 percent of new trusts are being established in Pennsylvania? I guess you answered correctly that, yes, that's true for today and the future's trusts.

Is it your feeling we still need to roll the ball forward on reform measures because there's a lot that precedes today? I mean, is that --

MR. RAWSON: Yes.

REPRESENTATIVE MANDERINO: It is those trusts and those people and family affected by those trusts that have a huge impact if the numbers of people -- If you know the actual numbers I'd appreciate that being part of the record. I just don't remember what they are. I know that Pennsylvania is a leader.

MR. RAWSON: Yes. It's in the hundreds of thousands of trusts. It's a very large number of trusts.

REPRESENTATIVE MANDERINO: I wrote down four specific reform measures that you recommended. I want to ask you a few things about that. One of the things was make statutory the ability of family members or independent trustees to remove if circumstances changed. I wasn't sure if you meant family circumstances because, then later you talked about banking circumstances.

If it's not statutory now, does it only exists if there was a foresight to put a portability clause or if a court determines that it exists, or how does it exists now and what would making it statutory to?

MR. RAWSON: What I'm suggesting is that the portability would be as far as the circumstances of the trustee change. Let me be very precise about why I separate individual trustees from corporate trustees.

If I trust you to look after my kids' finances and I trust you enough to continue to run their trustee after they're adults is because I know you and I know you are a fixed commodity that I can rely upon. You do not change. You do not get bought out the way a bank does and find that there are all these other competing bank agendas.

One of my comments, which I did not go into because I didn't want to get into what I felt was appropriate reform, is that I think people who trusted individuals -- those trusted individuals should not be easily changed because that is part of my expression of confidence.

But frankly, whether I choose bank A or bank B, I know darn well the management is going to change. For someone to say that my Will about bank A or bank B should be respected the way I trusted you personally; that's a fiction. We have to draw this distinction between corporate and noncorporate fiduciaries.

I strongly support legislation going from corporate to corporate for the good of the industry. I do not support legislation that goes from corporate to an individual. I want to keep the trust industry strong, and I want to make sure that if the trust leaves PNC it will go to Mellon or vice versa. I want this to be a zero-some game between the corporate fiduciaries because I do believe there is an intent by the person who sets up the trust. It's like I want the expertise of a corporate fiduciary.

Now there's some people that say, they're a bunch of road corporate fiduciaries out there. They'll make side deals with your family just to move it out. Listen, those road corporate fiduciaries, that is a fiction.

I've never known a corporate fiduciary that wasn't regulated by the same Department of Banking, subject to the same Orphans' Court jurisdiction, same rules in Pennsylvania and is about to tell somebody, well, we'll break all the laws of trust if you move it in here because they'll be sued for their eyeteeth if they do. I want to dispel that idea of the road corporate fiduciary real fast.

REPRESENTATIVE MANDERINO: You mentioned, I missed the section number of the current, and I'm not even -- Are we talking sections of the probate or banking code?

MR. RAWSON: Well, I actually cited two. One is the banking code of 1608. That is the Probate Code with 1701.

REPRESENTATIVE MANDERINO: In 1608 banking, there is currently something now that says if your institution changes you have 90 days that you can move. Right now in that short window there is the ability to move corporate to corporate, correct?

MR. RAWSON: That's correct, but virtually nobody is informed of that right within that period and, frankly, people aren't thinking that. I've seen those notices go out.

REPRESENTATIVE MANDERINO: Okay. Now, my question is, under that provision can you, am I correct, can only move corporate to corporate? You can't move corporate to individual as you --

MR. RAWSON: You're correct.

REPRESENTATIVE MANDERINO: One of your recommendations was to lengthen that time period.

MR. RAWSON: That's correct.

REPRESENTATIVE MANDERINO: Would a second recommendation be or does it already exists a notice provision that's basically like mandatory that goes out that says, we switched banks and under state law you have an ability to as a trust client you can do XYZ? Is that now

MR. RAWSON: I believe that notice is required. To be honest with you, I haven't looked at that provision for some time and only came to mind again when Mr. Hollinger mentioned that in his testimony and it's written up in his notes. He wasn't very clear about that, so without reviewing that statute I'm not a hundred percent clear myself. But I do remember such notices being sent out, but in a very, very perfunctory format. That, you know, nobody would realize that in a boilerplate that that was as momentous as it was.

REPRESENTATIVE MANDERINO: In some instances we under state law require that particular types of notices actually be mailed separately or written in a different colored ink or in a certain size type face. Maybe the better thing to do is, I'll go back and look and see what requirements are around that issue.

But I would be interested in -- Let me finish my last couple questions. Probate Code Section 7121, your opinion was wasting and gross mismanagement was too high of a standard given the way it's applied. Do you have a proposal or if you want to think about it, I would be if you want to think about it, I would be interested in what your thoughts would be. You mention changing to a looser standard, but you didn't mention anything specific.

MR. RAWSON: Yes, I will be happy to mention something specific. The three things that are in the current legislation actually are good standards and they are far more precise than what's in 7121. People are complaining about, well, how sufficiently, unsatisfactory does the service have to be or the investment performance or the fees have to be?

As you know the law is full of reasonable standards. I think this is probably -- and it was also done with an idea of satisfying the Internal Revenue Code as to getting external ascertainable standards. These are ascertainable standards as far as the IRS is concerned and that's certainly a lot better than gross mismanagement.

How gross is gross mismanagement? I will agree that it's very difficult to be completely precise about what will be sufficient cause to move a trust.

For example, I get people who call me

up at least once a week, Mr. Rawson, could we possibly move our trust out of bank X to you? Do you realize that after 10 years my checks for the income still don't come on time; still don't come to the right address even though I moved two years ago?

Well, this isn't necessarily gross mismanagement, but my gracious, if the bank can't get some of these basic things straight by that amount of time, you really have to wonder how much attention these people are getting.

REPRESENTATIVE MANDERINO: In the last question you mentioned unilateral escalator clauses. I wasn't sure if I understood that your comment was currently there's no prohibition against such and that we should have a statutory either a prohibition or regulation of that.

If that was your suggestion, is it something that you would suggest that is, requires, for example, approval of the banking department or legislative approval that would have to come back for a change? I'm not quite sure if I understand specifically.

MR. RAWSON: There are several ways of

addressing this. One way, frankly, would just be for the Orphans' Court to say, we realize this is a longstanding practice in the trust industry that we just allow trust departments to bump up their fees and there's no appeal.

If it's not absolutely outrageous on its face, so, what the heck. The guy signed an agreement that said you can raise your rates. So unless you quintuple them every three weeks or something, why, I guess that's perfectly enforceable. It's a contract. I think that really should be against contract law.

I can't imagine in this consumer stage we live in, if you were to buy a contract for any other services, and in there's a little bit of boilerplate saying, by the way, we can raise our rates whenever we want, but you can't get out of this contract. You and your heirs are stuck with us forever.

But we on our side, so long as we aren't outrageously wasting the assets of the trust and bump up the fees whenever we want, nobody will stand for that, and yet this is one of the really bad things in the trust business, and one of things that I think is scaring the people away, because they hear stories about --

They don't necessarily know what a unilateral escalator clause is, but they know they are not happy about the way banks are always bumping up their fees. They do it because of this. It could be stopped if a court were to say we consider this avoid against public policy, but no one's ever done that. Maybe no one's ever even litigated the matter because, again, you have to be in the trust business awhile to know about things like this. It could be done statutorily.

Now, there's an interesting question which we could get into at some point as to those states, Mr. Sozio was speaking about them I think. New York and New Jersey have statutory trust rates, and that's it. Everybody charges those rates, or a state like Pennsylvania which goes under reasonability.

I am not prepared to say that we should go under statutory rates and not reasonability. I do think that reasonable rates are what the marketplace determines, however. And that if we want to avoid the straightjacket on all parties of statutory rates, then we have to make it a two-ended agreement as to what reasonable rates are and allow competition as to rates, and that's why again I support this legislation.

REPRESENTATIVE MANDERINO: Thank you. I guess I just want to invite you and, actually, it's an invitation to everyone or anyone who has interest in this issue. I am not wedded to the exact provisions in House Bill 326. I am wedded to the notion that something has to be done and some reform is needed.

I would be very open and interested in your specific suggestions, whether it's amendments to 326 or a redraft of 326, or a proposal that is different but it attacks the same interest. I make that offer to all of the interests in the room today; that I'm more than open to suggestion, but am committed to moving forward. Thank you. Thank you, Mr. Chairman.

CHAIRMAN PICCOLA: Thank you, Mr. Rawson. This meeting stands adjourned.

(At or about 1:45 p.m., the hearing adjourned)

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C E R T I F I C A T E

I, Karen J. Meister, Reporter, Notary Public, duly commissioned and qualified in and for the County of York, Commonwealth of Pennsylvania, hereby certify that the foregoing is a true and accurate transcript, to the best of my ability, of my stenotype notes taken by me and subsequently reduced to computer printout under my supervision, and that this copy is a correct record of the same.

This certification does not apply to any reproduction of the same by any means unless under my direct control and/or supervision.

Dated this 28th day of October, 1995.

Karen J. Meister

Karen J. Meister - Reporter
Notary Public

My commission
expires 10/19/96