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The Use and Abuse of Incentive Trusts: Improvements and Alternatives

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¶ 1100 Section One: Introduction

Most estate planners have listened to clients expressing concern about the possible negative effects their money has or will have on their children. Most of us hear such comments as "My child doesn't have the slightest idea of the value of a dollar;" "She will blow through her inheritance in five years;" and "If I leave my money to my son, he'll never do anything with his life."

These concerns are certainly not new. Almost a quarter of a century ago, two of the co-authors of this article wrote "Estate Planning for the Postponed Generation," published in the 1987 UCLA Estate Planning Institute. The genesis of the article was a questionnaire sent by two of the co-authors to the California Fellows of the American College of Trust and Estate Counsel[1] asking about their experiences with incentive trusts. Answers to the questionnaire disclosed that an increasing percentage of estate planning meetings were being devoted to the concerns of clients who were dealing with children in their twenties and thirties who were emotionally and financially immature.

Roughly twenty percent of the Fellows responding to the questionnaire were disapproving of the concept that estate planning could be used to motivate children or to instill missing values. One response cogently described the idea as

> *a psychologically nonsensical attempt to continue the parents' dominant role into eternity. The idea that a lawyer estate planner has the knowledge or even the right to attempt to remedy parental failure of another is ridiculous. . . .*

Another Fellow commented:

> *I doubt that any sort of financial carrot will change a wastrel . . . . into a pillar of the community. . . .[T]he widow should be protected or provided for, depending upon her degree of sophistication. . .and the next generation should if physically and mentally normal, be permitted, at least by age 25, to blow it, or invest it wisely, as the spirit moves. Beyond that age, I doubt that "protection" is practicable, or wise. . . .If a normal child, of either sex, is unable to handle money wisely by age 25, he or she is best served by being allowed to spend it, and start from scratch. Any other*

[1] Among the Fellows who responded to the co-authors' poll were Phillip M. Lev, Brooks Crabtree, J. H. Perkins, William B. Lynch, James D. Devine, Rawlins Coffman, Lloyd W. Homer, Robert A. Schlesinger, Robert A. Mills, Fred L. Leydorf, Luther J. Avery, George W. Vinnedge, Paul N. Frimmer, Arnold D. Kahn, Robert L. Risley, Martin H. Webster, John W. Schooling, H. Neal Wells III, Christopher L. Carpenter, George T. Cronin, and John T. Pigott. This article benefitted from their thoughts, reservations, and suggestions.

approach produces a psychological cripple, with no chance at all of living a complete and productive life.

The remaining eighty percent of the Fellows accepted as a given, with varying degrees of reluctance, that they were drafting such plans at their clients' request but voiced uniform skepticism whether the plans would accomplish their desired goals. Yet unanimity existed about one perspective, typified by this Fellow's comment:

To my clients whose children are disappointments, lazy, or indolent and fail to live up to their potential I say that no device that I can draft will make up for lessons that were not learned as a child.

Another Fellow added:

If a parent has failed in his or her parental duty to provide guidance to children and instill a will to succeed, it is silly to think the parents may delegate the 'cure' to a mercenary.

The authors of the article found themselves in full agreement with the estate planner who commented:

[I]t is not the money that destroys our children, but the parents who earn the money but neglect to instill values in their offspring. . . . The bottom line is that incentives and encouragement of productive behavior have to be done during lifetime and are difficult to make successful in an estate plan when they have not been effective during life.

Despite these reservations, one approach adopted by many of the respondents to the questionnaire was to suggest an incentive trust. An incentive trust attempts to influence beneficiary behavior through a carrot/stick approach to trust distributions and trusteeships. Beneficiaries who engage in behavior which the trust creator seeks to encourage receive money and possibly trusteeships. Behavior which the trust creator seeks to discourage is punished through the withholding of trust distributions and trusteeships.

Incentive trusts as a form of conditional wealth transfer was explored by Judy Barber, a mediator and therapist, in her article *The Psychology of Conditional Giving: What's the Motivation*[2.] Barber set the stage for conditional giving and incentive trusts with this observation:

A generation raised in an upper-class environment with attendant educational, cultural, and material advantages may not have the same drive and ambition as the senior generation who grew up poor, with memories of not enough of anything. The work ethic of those parents,

2 Barber, J. (2007). The Psychology of Conditional Giving: What's the Motivation? Probate & Property, November/December.

whether driven by passion or fear of poverty or some of both, created a level of responsibilities outside the family that perhaps meant less contact with their children, who may have preferred the parents' presence to the wealth that was gained in their absence. This can lead the children to a different set of beliefs and a desire for another kind of lifestyle other than that of their hard-working father or mother. The dancer, high school coach, social worker, or stay-at-home Dad may have less wealth to leave than an entrepreneur, but have provided something that their children value more. Yet it is often difficult for self-made clients to embrace the choices of the second or third generations who may place a different value on things than material wealth, in part because the first generation afforded them the luxury to do so! Parents may want to pass notions of frugality, hard work, and sacrifice to the next generation, which can be difficult to do in the midst of substantial affluence.

According to Barber, incentive trusts represent to many clients the following statement: *This is what I value and I want to ensure my legacy is not wasted through the irresponsible spending of my hard-earned resources.*

At first glance, incentive trusts seem a reasonable approach to motivate the next generation to engage in behavior the trust creator approves of and to discourage behavior the trust creator wishes them to avoid. After all, people typically work for a living, with their income contingent upon the satisfactory completion of that work. Doesn't the business world pay for performance? Aren't incentive estate plans merely a reflection of real life? Why not employ the power of money to motivate desired behavior in the beneficiaries?

Section Two of this article examines the validity of the underlying assumption in incentive trusts, namely that money can be used effectively to motivate future generations to behave in a manner consistent with the trust creator's values. It explores some of the major studies in the field of motivational psychology over the last forty years by organizations ranging from Harvard Business School to the London School of Economics and the Federal Reserve Bank. Section Three will catalogue both the most typical drafting approaches to incentive trusts and the many difficulties inherent in administering such trusts.

Section Four will then discuss a new approach to aligning trusts, money and settlors' expectations, based upon the recent advances in understanding motivation and behavioral change. We will describe the concept of a Results Oriented Trust Environment (ROTE) which uses behavioral benchmarks that focus on and correlate with the beneficiary learning and demonstrating financial literacy and money management skills. Using the ROTE concept, we will propose what we describe as a Financial Skills Trust as a better way to draft and administer healthy, practical, and accountable provisions that both beneficiary and trustee can understand and follow. We then delineate in Section Five the fundamental elements in a Financial Skills Trust along with recommendations for evaluating beneficiaries' skills in operational terms. Finally, Section Six provides an example of the approach the estate planner might follow when drafting a Financial Skills Trust with interested clients.

¶ 1102 Section Two: Incentives and Incentive Trusts

Jacob Needleman, author of the seminal work, *Money and the Meaning of Life* (1991), once commented that

> *..in no other culture or civilization that we know of has money been such a pervasive and decisive influence. In the world we now live in money enters into everything human beings do, into every aspect and pocket of life.*

Similarly, in commenting on the power of money to incentivize behavior, Boston psychiatrist Edward Hallowell and Merrill Lynch broker William Grace, co-authors of *What Are You Worth* (1988), stated with no little irony that *"the average person would not uproot his family and move across the country for sex, but he almost certainly would for enough money."*

With such powerful endorsements, there is little wonder that money is used as the reward in virtually all aspects of contemporary life, ranging from parents' offering children $10 for each A on their report card to multimillion dollar retention and performance bonuses being paid by Wall Street investment banks. Most Americans would also endorse the idea that money is a powerful motivator, if not the most powerful motivator. Estate planners and their clients are not immune to the lure of using money to control behavior, in this case to encourage or discourage the behavior of succeeding generations.

¶ 1102.1. What Is the Effectiveness of Money in Motivating Behavior?

Despite the supposedly obvious idea that money makes the world go 'round, a review of both the estate planning literature and major studies in motivational psychology over the last forty years identify three major drawbacks to the use of incentive trusts:

1. Incentive trusts do not appear to be effective in developing the skills they seek to encourage in beneficiaries, e.g., work ethic, responsible money management and empathy for others leading to involvement in philanthropy. Money is an effective incentive if the behavior that is being incentivized is routine and boring, such as working on an assembly line repeatedly engaging in the same procedure hour after hour. It is not an effective incentive if the behavior that is being incentivized involves cognitive skills (memory, judgment and reasoning.) This finding has profound implications for incentive trusts since such trusts are attempting to incentivize such cognitive skills as a work ethic, responsible money management and empathy for others (philanthropy).

2. Incentives have proven to be an effective means of encouraging the very behaviors the employer actually would want to discourage. In this dimension, incentive trusts appear to work too well. Studies have documented numerous situations where using money as an incentive in the workplace may lead to unethical behavior by the employees being incentivized. Although unethical behavior by beneficiaries of incentive trusts does not appear to be well-documented in the estate planning literature, there is anecdotal evidence that incentive trusts have inspired some beneficiaries to game the system and present the trustee with fraudulent evidence of employment or school attendance in order to qualify for incentive distributions.

3. Many incentive trusts are inflexible and difficult to administer.

Sections Two and Three will examine these drawbacks. Since our intention is to introduce modern management theory and motivational studies into the discussion of incentive trusts, we will spend the bulk of our time on the first drawback.

¶ 1102.2. Incentive Trusts Are More Likely to Thwart Development of Motivation than Support It

The typical incentive trust encourages specific behaviors because the settlor believes such encouragement (read: motivation) will produce behaviors indicative of a desired level of maturity or desired skills in the beneficiary. For example, provisions which make distributions contingent on graduation from college or which match income of the beneficiary from full-time employment assume that these behaviors are evidence the beneficiary has developed a work ethic or the ability to manage money responsibly. Both terms – a "desired level of maturity" or "desired skills" -- are simply ways of describing behavior that is cognitively complex, self-motivated, and intrinsic to the individual. The more we learn about motivation, the more it appears that attempts to incentivize cognitively-complex intrinsically-driven behaviors are counter-productive and produce exactly the opposite result, namely a child with a poor sense of self-motivation, poor effectiveness in life skills, and even poor self-confidence. In fact, more than a hundred studies since 1970 have demonstrated that money incentives actually decrease the kind of personal growth and self-motivated behaviors that settlors would want.

Daniel H. Pink, author of *Drive: The Surprising Truth About What Motivates Us*[3], suggests that an understanding of motivational psychology begins with Frederick Winslow Taylor's 1911 monograph, *The Principles of Scientific Management.* Taylor, as one of the first management consultants, almost single-handedly created the management – and motivational -- system currently used by most major corporations today. When Taylor published his monograph, the United States was a manufacturing economy. Employees largely produced goods, not services, and most engaged in routine, repetitive tasks. Taylor's great insight was that those tasks could be broken down into discrete portions and employees could be trained to perform them as efficiently as possible. A fundamental principle of Taylor's concept of scientific management was that the

3 Pink, D. (2009). *Drive: The Surprising Truth about What Motivates Us,* Penguin Group USA

employees' training and performance should be enforced by management using a combination of incentives and punishments.

> *"It is only through* ***enforced standardization*** *of methods,* ***enforced adoption*** *of the best implements and working conditions and* ***enforced cooperation*** *that this faster work can be assured. And the duty of enforcing the adoption of standards and enforcing this cooperation* ***rests with management alone****."*[4] *(emphasis in the Taylor monograph).*

Over the past four decades, the American economy has moved away from producing goods to providing services, such that the service-producing sector has accounted for an increasing proportion of workers. In 1970, for example, there were 48.8 million service-providing workers and 22.2 million people in the goods-producing sector, a service-to-goods ratio of 2.2 to one. By 2005, workers who provided services (111.5 million) outnumbered workers who produced goods (22.1 million) by a ratio of five to one[5]. What this shift from a manufacturing economy to a service economy means is that employees increasingly are no longer attaching Nut #31 to Bolt #31 eight hours a day on an assembly line, able to be motivated by a piecework incentive system. Instead, modern employment more often requires creativity and other cognitive skills.

In response to this shift from a manufacturing economy to a service economy, organizations ranging from business schools to the Federal Reserve Bank have begun to question Taylor's carrot/stick theory of management. This is a result of studies in the fields of psychology and sociology which analyzed whether incentives enhance or reduce creativity and other cognitive skills needed for modern work and life. Here are some of the more groundbreaking studies in this area:

- A pioneering study was published in 1971 by Edward Deci, Director of the Human Motivation program at the University of Rochester[6]. Twenty-four college students were divided into two groups and each given a "Soma Cube" to assemble; this was a toy-like device that might be considered a distant ancestor of the Rubik's Cube popular in the 1980s. The various pieces of the Soma Cube could be put together in 240 different configurations. The experiment was divided into three sessions. In each session, the students were seated at a table on which there were a disassembled Soma Cube, three drawings of various configurations that could be constructed, and the latest issues of the *New Yorker*, *Time* and *Playboy*. In each session, the students were asked to try to create the configurations shown in the drawings. There was an eight-minute break halfway

4 Taylor, *Principles of Scientific Management*, cited by Montgomery (1989), *The Fall of the House of Labor: The Workplace, the State, and American Labor Activism, 1865-1925*, Cambridge University Press, p.229.

5 Bureau of Labor Statistics published in Establishment Data Historical Employment (2005); (*Employment Status of the Civilian Noninstitutional Population, 1940 to Date*," in Current Population Survey, U.S. Department of Labor, Bureau of Labor Statistics, January 2006, http://www.bls.gov/cps/cpsaat1.pdf,

6 Deci, E. (1971). Effects of Externally Mediated Rewards on Intrinsic Motivation, *Journal of Personality and Social Psychology*, Vol. 18, No. 1, 105-115

through each session during which the experimenter left the room and the students were told they were free to do whatever they wished. The students were observed through a one-way mirror and the time they continued working on the Soma Cube during the break was recorded.

In the first session, neither group was paid. In the second session, one group (the experimental group) was paid $1 for each configuration they could complete and the other group (the control group) was not. In the third session, neither the experimental group nor the control group was paid.

In all three sessions, all of the students in both groups continued to spend some time during the eight-minute break working on their Soma Cube. However, during the third session, the students in the experimental group - the group which had been paid in Session Two - substantially *reduced* the time they spent working on the Soma Cube during the break, compared to the amount of time they had spent working on the Cube during the breaks in the first and second sessions and compared to the control group. In other words, paying the experimental group to create configurations resulted in their classifying the Soma Cube as "work," which then led the subjects to become *less* internally motivated to devote time to the project during their break.

In *Drive*, Daniel Pink describes this as the Tom Sawyer Effect: paying someone to do what they initially viewed as intrinsically interesting turns it into work that is less interesting. Social psychologists forgo the literary allusion and refer to this as the "Yerkes-Dodson Law," in honor of pioneering work on incentives done in 1908[7].

- Three researchers soon duplicated Deci's experimental design while working with four year olds selected from the Bing Nursery School at the Stanford University campus[8]. Once again, the experiment was divided into three phases. During the first phase, the experimenters watched through a one-way mirror and identified approximately 50 children who liked to draw. The experimenters kept records of the amount of time each child spent drawing during the day. In the second phase, the teacher asked each of the 50 children if he or she would like to draw pictures for the experimenter. The teacher told approximately half of the children (the experimental group) that they would get a Good Player Award for drawing pictures for the experimenter. The other half of the children (the control group) were not told about an Award. The teacher would take the child into a separate room with the experimenter and the child would be asked to draw something. Each child who had been promised an award was given one. In addition, approximately half of the children who had not been told about the Good Player Award were given one anyway as a surprise. During the next two weeks, the

7 see Yerkes, Robert M., and John D. Dodson, "The relationship of strength of stimulus to rapidity of habit-formation," *Journal of Comparative Neurology of Psychology*, XVIII (1908), 459-482.

8 Lepper, Greene & Nisbett (1973). Undermining Children's Intrinsic Interest With Extrinsic Reward, *Journal of Personality and Social Psychology*, Vol. 28, No. 1, 129-137.

experimenters kept track of how much time each of the 50 children spent drawing. The control group -- children who did not receive a Good Player Award and children who received the award as a surprise – continued to draw at a rate consistent with their baseline in the first phase. Children in the experimental group – those who had been promised the Award in advance – reduced the time they spent drawing *by more than fifty percent*. The incentive – the Good Player Award – had turned play into work.

- In 1999, Deci and two colleagues published an analysis of 128 studies where these results were replicated time after time in carefully controlled experiments9**.** Their conclusion:

> *Careful consideration of reward effects reported in 128 experiments leads to the conclusion that tangible rewards tend to have a substantially negative effect on intrinsic motivation. . . Even when tangible rewards are offered as indicators of good performance, they typically decrease intrinsic motivation for interesting activities. Although rewards can control people's behavior—indeed, that is presumably why they are so widely advo-cated—the primary negative effect of rewards is that they tend to forestall self-regulation. In other words, reward contingencies undermine people's taking responsibility for motivating or regulating themselves. When institutions— families, schools, businesses, and athletic teams, for example—focus on the short term and opt for controlling people's behavior, they may be having a substantially negative long-term effect. Furthermore . . . . . when organizations opt for the use of rewards to control behavior, the rewards are likely to be accompanied by greater surveillance, evaluation, and competition, all of which have also been found to undermine intrinsic motivation. . . Research has shown the value of being intrinsically motivated in many applied settings such as education, sports, and work environments. In addition, research on intrinsic motivation has focused attention on the more general benefits of supports for autonomy and competence for motivated persistence, performance, and wellbeing. (emphasis added)*

Although the results of 128 studies on experimental motivation sound impressive, do these really apply when these conclusions are expanded to incentive trusts? After all, incentive trusts do not involve $1-per-project payments or Good Player Awards. Trusts may have a corpus in the millions of dollars. Wouldn't such a large incentive be able to do what smaller incentives do not? What happens when incentives can result in distributions that would make a significant economic difference for the beneficiary?

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9 Deci, E., Koester, R. & Ryan, R. (1999). A Meta-Analytic Review of Experiments Examining the Effects of Extrinsic Rewards on Intrinsic Motivation, *Psychological Bulletin,* Vol 125, No. 6, pp. 627-668.

Recent motivational studies using financial rewards have confirmed that, although significant incentives can improve work performance based solely on pure effort such as repetitive assembly-line tasks, incentives often paradoxically decrease performance based on cognitive skills such as creativity or concentration. Here are several notable examples of such studies:

- In 2005, the Federal Reserve Bank of Boston engaged four prominent economists -- Dan Ariely of MIT, Uri Gneezy of the University of Chicago, George Lowenstein of Carnegie Mellon University and Nina Mazar of the University of Toronto – for several studies on financial incentives and performance[10].

  The first study used a small village in India where the cost of living is so much lower than in the United States that a limited amount of money makes a significant difference in one's standard of living. Eighty-seven participants were recruited from the village and asked to engage in six activities. Three activities involved some degree of creativity or concentration, such as unscrambling anagrams or recalling a string of digits. The other three required some degree of motor skills, such as throwing a ball at a target. Performance targets were established for each of the activities. The participants were divided into three groups, with progressively larger incentives. Group One participants were offered 4 rupees for each performance target they met, Group Two participants were offered 40 rupees per target, and Group Three participants were offered 400 rupees per performance target. If Group Three participants met all six performance goals, they would receive an amount approximately equal to half of the mean yearly consumer expenditure in the village, a potentially meaningful increase in their standard of living. Two findings stood out. First, there was no significant difference between the performances of Group One and Group Two, those groups with incentives at the daily or weekly wage level. Second, Group Three participants did *worse* than either Group One or Group Two, especially in the tasks that required creativity or concentration, even though the incentive was close to six months' wages.

  In the second Fed study, different experiments were carried out at MIT and at Chicago near the end of the semester, a time when the students have usually depleted their budgets and are thus more strapped for cash. At MIT, the experiment involved two tasks: one involving routine behavior (a key-pressing task where students had to alternate between pressing two separate keys on a keyboard) and one requiring more concentration and cognitive ability (an addition task where students were asked to find within various 12-number matrices two numbers that could add up to 10). Performance targets were established with rewards ranging from zero to $300. At Chicago, the study substituted social incentives in lieu of financial incentives by structuring problem-solving activities conducted either privately or in front of an audience.

10 *Large Stakes and Big Mistakes*, Federal Reserve Bank of Boston Working Paper No. 05-11, July 23, 2005.

The results were again consistent: larger incentives increased the purely routine behavior and served as a disincentive when the tasks involved creativity or concentration. The study concluded:

> *Many existing institutions provide very large incentives for exactly the types of tasks we used here – those that require creativity, problem solving, and concentration. Our results challenge the assumption that increases in motivation necessarily lead to improvements in performance. In eight of the nine tasks we examined across the three experiments, higher incentives led to worse performance…Do administrators who are in charge of setting compensation have greater insight into such effects? The prevalence of very high incentives contingent on performance in many economic settings raises questions about whether administrators base their decisions on empirically derived knowledge of the impact of incentives or whether they are simply assuming that incentives enhance performance.*

- Similar conclusions were reported in 2009 by Santa Fe Institute Professor and behavioral scientist, Samuel Bowles, who, under the auspices of the London School of Economics, conducted an analysis of 51 separate experimental studies of financial incentives in employment relations[11]. Bowles found overwhelming evidence that these incentives reduce an employee's natural inclination to complete a task. Rather than performance-related pay encouraging employees to work harder, Bowles' research shows the opposite: many employees have a loss of motivation and a diminishing capacity for fairness and other workplace ethics.

- The effect of money incentives on behavior answers the age-old question all of us have faced if we have ever been in Manhattan on a rainy day: where did all the cabs go? A 1997 study[12] discovered that most cab drivers set a monetary goal for themselves per day, namely, to earn twice as much as it costs for them to rent a cab for a twelve-hour shift. Since more people are looking for cabs when it rains, the drivers reach their monetary goal earlier in the work day and go home, even though they could earn substantially more money simply by continuing to work. As the authors of the study commented:

> *This finding flies in the face of the economic tenet of wage elasticity, which predicts that people should work more hours on days when they can earn more money and less on days when they earn less. If NYC taxi drivers used a longer time horizon (perhaps weekly or monthly), kept track of indicators of increased demand (e.g., rain or special events), and ignored their typical daily goal, they could increase their overall wages, decrease the overall time they spend working, and improve the welfare of drenched New Yorkers.*

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11 See www.finchannel.com, LSE: When Performance-Related Pay Backfires, 24/06/2009

12 Camerer, C., Babcock, L., Loewenstein, G., & Thaler, R. (1997). Labor Supply of New York City Cabdrivers: One Day at a Time, *The Quarterly Journal of Economics*, 112(2), 407- 441.

It is also arguable that the cognitive behaviors which most incentive trusts hope to grow are not even reliable predictors of the primary goal of an incentive trust, namely, the ability of the beneficiary to manage money responsibly. Consider, for example, an incentive trust which provides funds contingent upon the beneficiary's completion of a college education as well as income matching for full-time employment. Both the estate planner who drafts the trust and the settlor who signs it most likely assume that the behavior being rewarded – attending college and being employed – will assure that the beneficiary has attained a desired level of financial maturity and responsibility so that disastrous financial outcomes are unlikely. This is not necessarily true.

According to The Foundation for Financial Literacy (http://www.financiallit.org/), the percentage of Americans with at least one semester of college education who file for bankruptcy protection is nearly identical to the overall percentage of the population with the same educational level. Specifically, in 2008 (the most recent data available) the 53% of the U.S. population which had attended at least one semester of college accounted for 55.6% of all bankruptcy filings. If higher education were a reliable indicator of responsible money management, one would think that the percentage of people filing for bankruptcy protection who had at least some college education would be substantially less than such group's overall percentage of the population. As most of us know from our practices, the fact that someone has substantial earned income or a college education is not in the least predictive of whether this person lives within his or her means.

¶ 1102.3. The Relevance for Development of Healthy Personality in Beneficiaries

Why then does money reinforce simple work tasks but backfire for growing complex cognitively challenging tasks? The answer lies in understanding the nature of the behaviors aimed at being incentivized. The answer, in essence, lies within us.

On the most basic level, what do parents typically want for their children? Based on our work with families and estate planners over many years, we would answer that what most parents want for their children is to exhibit what psychologists call a strong sense of *self-efficacy*. Self-efficacy is the belief in one's ability to succeed in life. It is a Can Do attitude. With a well-developed sense of self-efficacy, we approach difficult tasks as challenges to be mastered rather than as threats to be avoided. We set ourselves challenging goals and maintain strong commitment to them. We heighten and sustain our efforts in the face of failure. We recover our willingness to try again after failures or setbacks. We attribute failure to insufficient effort or deficient knowledge and skills which are acquirable. We approach threatening situations with the belief that we can exercise control over them. Such an outlook produces personal accomplishments, reduces stress and lowers vulnerability to depression.

On the other hand, people with a poor sense of self-efficacy doubt their capabilities and shy away from difficult tasks which they view as personal threats. They have low aspirations and weak commitment to the goals they choose to pursue. When faced with difficult tasks they dwell on their personal deficiencies, the obstacles they will encounter, and all kinds of adverse outcomes rather than on how to perform successfully.

They slacken their efforts and give up quickly in the face of difficulties. They are slow to recover following failure or setbacks. Because they view insufficient performance as deficient aptitude it does not require much failure for them to lose faith in their capabilities. They fall easy victim to stress and depression.

How is a sense of self-efficacy developed? The most effective way is through what are commonly referred to as *mastery experiences*[13.] These are opportunities to succeed. These begin when parents provide young children with such opportunities on a relatively small scale, ranging from putting their toys away when they finish playing to learning to tie their shoes. They start small and give their child the opportunity to build on each successive success. Building on prior successes creates a robust belief in one's personal efficacy and ability to succeed. However, it is important that the parents give the child the opportunity to encounter some setbacks and difficulties along the way. Overcoming setbacks serves a useful purpose in teaching that success usually requires sustained effort. After people become convinced they have what it takes to succeed, they persevere in the face of adversity and quickly rebound from setbacks. By sticking it out through tough times, they emerge stronger from adversity.

People who exhibit a high degree of self-efficacy also exhibit what social psychologists call *autotelic behavior*. An autotelic activity is one we do for its own sake because to experience it is the main goal. In other words, autotelic behavior is behavior we engage in because we enjoy it. A person who exhibits a high degree of self-efficacy is internally motivated and usually not engaging in an activity for a reward or punishment. Engaging in a consistent work ethic or postponing spending and saving money are examples of autotelic behavior.

We have yet to encounter parents who want incentive trusts to motivate or control the behavior of children who already possess a Can Do attitude and strong sense of self-efficacy. Clients who are interested in incentive trusts are almost exclusively parents who complain about their children’s lack of self-motivation and self-efficacy, children who also have a corresponding expectation (or need) to be supported financially by their parents. As a demonstration of this, we encourage the reader to engage in a brief thought experiment. First, make a list of those clients who have expressed an interest in the use of incentive trusts. Second, draw a vertical line down the center of a piece of paper. Label the left side “strong self-efficacy” and label the right side “poor self-efficacy.” Using the roster of clients from the first step, list those clients whose children exhibit a strong sense of self-efficacy in the left column and those clients whose children exhibit a poor sense of self-efficacy in the right column. Compare the number of families in each column. Typically, when we ask estate attorneys or financial planners to engage in this experiment, the left column is blank or nearly so. This is why many estate planners resonate with the comment of the anonymous ACTEC Fellow quoted in the introduction: *"To my clients whose children are disappointments, lazy, or indolent and fail to live up to their potential I say that no device that I can draft will make up for lessons that were not*

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13 (Bandura, A. (1994). Self-efficacy. In V. S. Ramachaudran (Ed.), *Encyclopedia of Human Behavior* (Vol. 4, pp. 71-81). New York: Academic Press. (Reprinted in H. Friedman [Ed.], *Encyclopedia of Mental Health*. San Diego: Academic Press, 1998).

learned as a child."

In her *Money and Soul* column entitled, “A Psychotherapist Looks At Incentive Trusts” in the December, 2004 issue of the *Journal of Financial Planning*, co-author Eileen Gallo made the following observations:

> *When we use money to motivate our children, we are creating external motivation rather than relying on their own enthusiasms and passions. As psychiatrist Ed Hallowell points out in The Childhood Roots of Adult Happiness, it is best for our children’s motivation to come from the inside and not to be supplied from the outside. “You may still deal with carrots and sticks, but if the carrot and the stick come from within a person, that system will last much longer than if the motivation comes entirely from the outside.” Hallowell believes that using money to motivate children is as likely to produce a depressed adult as it is to produce a materially successful one. And what is an incentive trust other than a sophisticated mechanism that uses money as motivation?*
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> *Social psychologist Mihaly Csikszentmihalyi, who coined the term autotelic, points out that the less parents rely on external motivators and the more they concentrate on helping their children become internally motivated, the happier their children will be. If we overemphasize the importance of money or rewards in achieving a goal, rather than the process of achievement itself, we run the risk of turning our child into a kind of money junkie who has no true enthusiasm for anything except more money. This is not a recipe for a meaningful or happy life.*
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> *University of Southern California economist Richard Easterlin, who has pioneered studies on the relationship between material goods and happiness, observed in an L.A. Times interview that the more we make, the more we want. Using money as a motivator simply makes us want even more. If materialism is our motivating factor, we can never get ahead of our material wants. Social psychologists call this the hedonic treadmill. The hedonic treadmill ensures that very few of us can be very happy for very long if what motivates us is getting more. As Easterlin comments, “Material aspirations change over the life cycle roughly in proportion to income.” The net result is that the more you have, the more you need, especially if someone you know already has it. Money and material goods are external; happiness is internal.*

¶ 1102.4. Incentive Trusts May Backfire in Other Ways

The Samuel Bowles (2009) meta-analysis of the interaction between pay and performance highlights another potential problem arising from the use of incentive trusts. Linking pay to performance may backfire by creating an environment which serves as an inducement to game the system and engage in unethical behavior. A recent Harvard Business School Working paper[14] observed that "substantial evidence demonstrates that . . . . . goal setting can induce unethical behavior." The study cites numerous cases of unethical conduct in the marketplace when employees attempted to achieve management goals. Prominent past examples include the following:

- Miniscribe, a leading supplier of Winchester hard disk drives, where employees counted scrap as inventory and packaged bricks and shipped them to distributors instead of disk drives in order to meet shipping targets in the 1980s;

- Ford Motor Company, which skipped safety tests with the Pinto and then failed to correct the design defect, causing the gas tank to explode in a rear-end collision because the cost of the resulting lawsuits was estimated at less than the cost to correct the problem;

- Sears' automotive unit, which charged customers for unnecessary or non-existent repairs to meet sales quotas;

- Bausch and Lomb employees who falsified financial statements to meet earnings goals; and

- Enron, where executives used "off the books" entities to hide debt.

Although unethical behavior by beneficiaries of incentive trusts does not appear to be well-documented in the estate planning literature, there is ample anecdotal evidence that incentive trusts have inspired some beneficiaries to game the system. Possibilities appear to be limited only by the imagination and creativity of the beneficiaries, greatly facilitated by the ease with which modern personal computers and printers make it possible to create fraudulent documents. The co-authors of this article have heard of trustees being presented with altered copies of state and federal income tax returns and W-2 forms (in order to obtain matching distributions) as well as purported college transcripts that reflect non-existent school enrollment.

¶ 1103 Section Three: The Difficulties in Administering Incentive Trusts

14 Ordóñez , L., Schweitzer, M., Galinsky, A. and Bazerman, M. (2009). *Goals Gone Wild: The Systemic Side Effects of Over-Prescribing Goal Setting,* Harvard Business School Working Paper No. 09-083, February.

The third and final problem with incentive trusts is that they are notoriously difficult to administer. The administrative difficulties created by incentive arrangements are amply illustrated by the fact that most of the discussions of incentive trusts found in the estate planning literature focus on this issue. Thus far, with the significant exception of an outstanding article by Marjorie Stephens, *Incentive Trusts: Considerations, Uses and Alternatives*, 29 ACTEC Journal 5 (2003), articles dealing with incentive trusts do not attend to the core question of whether such a trust is an effective means of motivating beneficiaries to engage in the desired activity. Rather, most articles focus on the problems encountered by trustees and beneficiaries in administering such trusts.

A review of the literature and conversations with estate planners suggest that there are three basic approaches to incentive trusts.

¶ 1103.1 Absolute discretion.

In this approach, the settlor(s) select a trustee who is perceived as sharing the settlor(s) values and provide the trustee with absolute discretion in making distributions of income and/or principal to the beneficiaries of the trust. In such a situation, the trustee's discretion is generally tested using a good faith standard. Section 50 of the Restatement of the Law of Trusts (Third) provides that:

> (a) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.
>
> (b) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purpose in granting the discretionary power and in creating the trust.

In some decisions, use of the terms "absolute" and "sole" seem to provide additional discretion beyond a good faith test. For example, In re Ledyard's Estate, 21 N.Y.S. 2d 860 (1939) aff'd 259 App. Div. 892, leave to appeal denied 284 N.Y. 819, the court held that a grant of "absolute discretion" meant that the trustee's exercise of such discretion was not subject to review. However, it is likely that most courts would still intervene if a trustee granted absolute discretion exercised it unreasonably. See Estate of Ferrall, 41 Cal. 2d 166 (1953). The topic of absolute discretion was covered in some detail in *An Examination of Trustees, Beneficiaries and Distributive Provisions,* Gallo, Zwicker and Barber, 2008 Institute on Estate Planning 15-1.

¶1103.2. The listing approach.

In this approach, behaviors which are incentivized or discouraged, together with the carrots and sticks attributable to meeting or failing to meet the designated criteria, are set forth in varying degrees of detail.

For example, the incentive plans suggested by many of the ACTEC Fellows responding to the 1987 questionnaire incorporated some or all of the following concepts:

- Behavior identified as "productive" was encouraged and rewarded monetarily. The two most common forms of productive behavior which were encouraged were graduation from college and full-time employment. Motherhood and caring for the home on a full-time basis were sometimes taken into consideration for purposes of such monetary award. Except as mentioned below, no benefits were payable if the child did not meet these basic standards.

- Ages of distribution were delayed. In some plans, achieving "productive behavior" resulted in distribution at an earlier age. Motherhood and caring for the home on a full-time basis were usually taken into consideration for this purpose.

- Virtually all plans granted the trustee the discretion to provide benefits if the child was physically or mentally disabled. The trustee was frequently authorized to purchase medical insurance for the beneficiaries.

- Some plans provided partial or complete forfeitures if the child did not meet minimum standards. For example, current income not distributable to the child might instead be distributed to charity. Other plans provided for termination of the child's trust and distribution of principal to charity if three to five consecutive years elapsed during which the child failed to meet the minimum requirements for income or principal distributions.

Drafting an incentive trust which uses the listing approach typically necessitates a high degree of specificity. For example, Nancy G. Henderson, *Managing "Carrot and Stick" Provisions: Selected Fiduciary Issues in Drafting and Administering Trusts with "Incentive" Provisions,* ALI-ABA Court of Study, Representing Estate and Trust Beneficiaries and Fiduciaries (2008), sets forth an exhaustive list of "tricks and traps" that should be considered or avoided. If an incentive trust includes a provision matching the beneficiary's earned income, Henderson points out the need for the trust to address such issues as:

- How is "earned income" defined? What about the self-employed beneficiary who minimizes his or her salary in order to minimize self-employment taxes? What if a gainfully employed beneficiary is temporarily disabled and receiving disability insurance payments?

- Since many income-matching provisions look to the beneficiary's income tax return to determine the property matching distribution, what happens if the return is audited and the amount of earned income is increased or decreased?

- Is the beneficiary's spouse's income taken into consideration, especially if the beneficiary chooses to stay home to care for children or dependent adults?

- What about the beneficiary who is unable to earn substantial income, or any at all, because of physical or mental disability?

- Do income matching distributions truly reflect the settlor's values? Did the settlor really intend to reward the beneficiary who is a highly successful producer of soft porn videos more than the beneficiary who is a highly regarded elementary school teacher?

Joshua Tate, a faculty member at Southern Methodist University, similarly devotes his excellent article, *Conditional Love: Incentive Trusts and the Inflexibility Problem*, 41 Real Property, Probate and Trust Journal 445 (2006), to the problems of administration created by incentive trusts which impose fixed conditions on distributions and leave little or no discretion to the trustee to determine whether the settlor would have approved of the beneficiary's actions. He comments that:

> *When an incentive trust is drafted to leave little discretion to the trustee, the possibility emerges that the trust will prove to be inflexible. A provision requiring a beneficiary to graduate from college in order to receive trust funds may create difficulties when the beneficiary has a serious medical problem that prevents her from attending school. A trust that awards a dollar of trust income for every dollar that the beneficiary earns on his own can discourage the beneficiary from entering a socially beneficial but less remunerative profession, such as teaching. . . . . . Incentive trusts pose this inflexibility problem: because the settlor cannot foresee all potential eventualities or circumstances and take them into account in the trust, the terms of the trust can prove to be a burden for the beneficiaries.*

For the estate planner whose clients prefer the listing approach to incentive trusts, the articles by Henderson and by Tate are must readings. They provide a thorough overview of many of the complex issues that are often addressed in such trusts, ranging from substance abuse to advisory panels and from marriage to trustee removal.

¶1103.3. Behavioral Benchmarking.

In *The Case for Principle Trusts and Against Incentive Trusts*, October 2008 Trusts & Estates, David Handler and Alison Lothes argue against a rigid listing of behavioral benchmarks, such as graduation from college or full time employment, and in favor of using what they refer to as Principle Trusts:

> *We believe that principle trusts are better. The provide no hard and fast rules, but instead offer guidance as to the settlor's values and principles, leaving it to the trustee to determine how to make distributions that are in line with such values and principles. The trustee is able to consider the big picture – the personality, talents and (dis)abilities of beneficiaries, their financial resources, their accomplishments and competencies – to determine how to best accomplish the objectives. Such a trust is better able to carry out the settlor's intent.*

In a Principle Trust, the trustee is provided with guidance embodied in a list of what the article describes as positive behaviors the client wishes to encourage. The article provides examples of various behaviors that might be on the list. These include pursuing an education at least through college, pursuing "gainful employment with a view toward being self-sufficient," becoming "a productive member of society by making meaningful and positive contributions to family, community and society" and handling "money intelligently and avoiding wasteful spending."

The increased flexibility of the Handler and Lothes approach and its focus on behavioral benchmarks is a welcome contribution to the literature of incentive trusts. However, we believe that some of the benchmarks are so subjective that both the trustee and the beneficiaries lack guidance as to how the benchmark is to be met. For example, the trustee is to consider whether the beneficiary is "avoiding wasteful spending." The application of this criterion appears to be entirely dependent on the trustee's value system and not on the settlor's values. Is a beneficiary engaged in "wasteful spending" if he purchases a 60 inch TV but not if he purchases the 42 inch version? Moreover, many of the behaviors the trustee is asked to take into consideration are subject to the same criticism articulated in Section Two: they are not necessarily indicators of the beneficiary's ability to manage money responsibly. Consider again, for example, the behavioral benchmark of "pursuing an education at least through college." Being a college graduate does not guarantee that one is neither a miser nor a spendthrift.

¶ 1103.4. How Motivation and Behaviors Are Successfully Integrated: Orienting to Results

Is it possible to address the many concerns of settlors, trustees and beneficiaries by creating behavioral benchmarks that not only are objective but correlate with the beneficiary's ability to manage money responsibly? We believe that the answer is "yes." The solution may lie with a recent innovation in management practices known as a ROWE – a Results Oriented (or Results Only) Work Environment. The ROWE was invented by Cali Ressler and Jody Thompson, executives who worked within the human resources department of BestBuy. They subsequently formed their own company and wrote *Why Work Sucks and How to Fix It,* Portfolio Hardcover, 2008, in which they describe the concept as follows: "*In a Results-Only Work Environment, people can do* *whatever they want, whenever they want, as long as the work gets done*." Since there are no fixed hours but rather fixed goals, employees in a ROWE are evaluated entirely on their results. According to a September 25, 2008 article by Lindsay Blakely on the online CBS Business Network, www.BNet.com:

> *Many of the productivity gains that result from a ROWE come from its effectiveness at retaining and motivating valued employees. At the same time, a ROWE exposes a team's underperformers, the ones who used to get away with contributing little. The net result is a stronger team that can do more with less. For example, after migrating to a ROWE, BestBuy's strategic sourcing and procurement team boosted employee retention by 27 percent and shed 10 low-performing employees. But the real proof was the huge uptick in performance: The department, which buys materials for the corporate environment, saw a 50 percent increase in cost reductions over two years.*

The core principle of a ROWE is that those who possess the financial rewards (the managers of a company) should focus on and reinforce the goals or results desired, not necessarily any predetermined structure, methodology, or pace of how the results are achieved. In doing so, a ROWE encourages the development of necessary skills and behaviors in employees as well as their autonomy and their growth. Those with good intrinsic motivation, self-efficacy, and autotelic behaviors tend to rise to the challenge and perform well. Those who lack these important characteristics typically don't sustain their work performance and do not get rewarded.

Suppose then that the underlying concepts of a ROWE could be applied to a trust. If the primary goal of the typical incentive trust is to encourage responsible money management by the beneficiary, the focus would be on the goal – responsible money management – and not on the process by which the beneficiary achieved that goal, especially highly unreliable and indirectly connected activities such as going to college or full-time employment. It would be possible to identify behavioral benchmarks or component skills that are not only objective but which correlate directly with the beneficiary's ability to manage money responsibly.

With a bow to Ressler and Thompson, we therefore suggest that the outcome would be the creation of a ROTE: a Results Oriented *Trust* Environment. We discuss this in depth in Sections Four and Five.

¶ 1104 Section 4 – Understanding the Financial Skills Trust within the Context of a Results-Oriented Trust Environment

Building on the evolving understanding about human motivation, methods of behavioral change, and the psychology of money and wealth, we propose a method of trust construction and drafting that moves us beyond ascertainable standards, incentive trusts, or use of absolute discretion to a coherent structure which focuses on the financial skills of the beneficiary. Our approach emphasizes four main components:

1. Using the fundamental structure of a largely discretionary trust rather than attempting to control the beneficiary's behavior through either (i) a restricted definition of what health, education, maintenance and support mean in order to limit what distributions may be made, or (ii) incentive provisions that tie distributions to specific behaviors;

2. Capturing the settlor's intent regarding financial skills through a clearly-stated outline of the trust's mission statement which addresses, *inter alia*¸ issues of trustee flexibility, desire to prepare the beneficiary, and handling of the risks inherent in learning skills for money management in life;

3. Elaborating the mission statement by delineating guidelines - but not requirements – focused on the results of the beneficiary's learning and demonstrating money management skills, results which the trustee takes into consideration when deciding whether to make discretionary distributions of income and/or principal;

4. Being transparent through open communication of the trust's provisions so that both the trustee and the beneficiary know the guidelines and how trustee discretion may be exercised.

A trust built upon these four principles employs the principles embodied in the Results Only Work Environment (ROWE) discussed previously. In effect, it creates a Results-Only Trust Environment (ROTE) or, as we prefer, a Results-Oriented Trust Environment which focuses on the beneficiaries' financial skills. We refer to such a trust as a Financial Skills Trust or FST. Like a results-oriented work environment, a Financial Skills Trust supports autonomy and accountability since trust distributions are tied to the beneficiary's money skills and little else. It also stays away from attempting to control from either the grave or the trustee's office the beneficiary's life choices or nonfinancial activities.

Although we are introducing the concept of a Results-Oriented Trust Environment in the context of a trust which emphasizes financial skills, there is no reason why ROTE should not be applied in other contexts. We think of a Results-Oriented Trust Environment as an umbrella set of principles, beneath which various trusts may be developed emphasizing different life skills. In addition to a Financial Skills Trust, a Results Oriented Trust Environment could be used by an estate planner to assist clients in developing a trust which emphasizes philanthropic or entrepreneurial skills, creating either a Philanthropic Skills Trust (PST) or an Entrepreneurial Skills Trust (EST). The key to drafting a trust in a Results Oriented Trust Environment is adherence to the four steps introduced at the beginning of this section.

¶ 1104.1 The Foundation of the Financial Skills Trust: Financial Literacy and Education

In order to understand the Financial Skills Trust, a review of the literature of financial literacy education is helpful. The main components of healthy financial skills have been clarified over the past twenty years as programs for developing financial literacy have developed and matured. Nationwide resources such as the National Endowment for Financial Education and the Jump$tart Coalition emphasize core skills for financial literacy that help avoid financial problems in adult life. Experts in financial literacy education for the wealthy in particular15 emphasize a basic cluster of healthy financial skills that typically involve some or all of the following list:

1. How to save
2. How to keep track of money
3. How to get paid what you are worth
4. How to spend wisely
5. How to talk about money
6. How to live on a budget
7. How to invest
8. How to exercise the entrepreneurial spirit
9. How to handle credit
10. How to use money to change the world[16]

These skills are highly relevant to trust construction and the exercise of discretionary powers by trustees. Financial literacy skills are often at the very heart of settlors' wishes that beneficiaries should demonstrate such subjective virtues as "prudent management of life skills," "work ethic," and "good stewardship of inherited assets." An unfortunate reality is that some inheritors do lack many financial skills, leaving them passive, dependent on advisors, purposeless, and/or having a sense of entitlement and self-centeredness[17]. The problem with the typical incentive trust is that it either discusses the beneficiaries' financial skills using vague and subjective phrasing or it employs over-reaching provisions that control life choices that do not truly relate to money skills.

Recent attempts to frame these skills using somewhat operational language have been suggested by Handler and Lothes (2008) in their work on Principle Trusts, and by John A. Warnick and colleagues[18] in their delineation of five possible "markers of maturity": financial self-sufficiency; pursuing work, career, education and/or self-advancement; reasonably free of problematic behaviors; social and emotional

15 Gallo, E. and Gallo, J. (2005). *The Financially Intelligent Parent: 8 Steps to Raising Successful, Generous, Responsible Children,* New York: New American Library; Gallo, E. and Gallo, J. (2002). *Silver Spoon Kids: How Successful Parents Raise Responsible Children*. New York, Contemporary Books; Godfrey, J. (2003), *Raising Financially Fit Kids,* Berkeley CA, Ten Speed Press.; Morris, R. and Pearl, J. (2010) *Kids, Wealth and Consequences: Ensuring a Responsible Financial Future for the Next Generation,* New York: Bloomberg Press.

16 List drawn from Godfrey (2003), *Raising Financially Fit Kids.*

17 For a comprehensive review of the psychology of wealth for acquirers and inheritors, see Jaffe, D. and Grubman, J. (2007), Acquirers' and Inheritors' Dilemma: Discovering Life Purpose and Building Personal Identity in the Presence of Wealth, *Journal of Wealth Management*, Fall, pp. 1 – 26.

18 Baris, M., Garrity, C., Warnick, C. and Warnick, J. (2008): Maturity Markers: A New Paradigm for Trust Distribution Models and Gifting Strategies, *FFI Practitioner*, Vol. 4, March.

involvement; and social emotional maturity. Though laudable as hallmarks of the purpose-driven life, we consider most of these five markers as still too subjective and global for use in trust construction focused on financial literacy. Only the first marker of maturity ("financial self-sufficiency") directly focuses on financial literacy skills which might be defined objectively. The others either touch upon aspects that may be covered under traditional trust provisions (e.g., "reasonably free of problematic behaviors" as a possible stand-in for substance abuse) or may be so difficult to agree upon between trustee and beneficiary (e.g., "social and emotional involvement") that the language risks inviting litigation.

Trustees need guidance, both conceptually and operationally, in the day-to-day administration of the trusts within their responsibility. Putting reasonably operational criteria on paper concerning the financial skills expected of the beneficiary enhances clarity not only for the trustee but for the beneficiary. Furthermore, knowing how to conform one's behavior to the discretionary provisions of the trust would, on its face, be a useful skill for the beneficiary. Doing so while avoiding infringement on the beneficiary's right to autonomy is even better.

We believe that incorporating guidelines for evaluating beneficiaries' money skills has several advantages when compared with the traditional incentive trust. It provides much more transparent criteria for both the trustee and beneficiary when discretionary distributions are requested. It capitalizes on our growing knowledge about motivation and financial literacy. Finally, it helps to prepare inheritors for handling wealth.

¶ 1104.2 Understanding the Financial Skills Trust Using the ROTE Principles

Let us examine the Financial Skills Trust within the four fundamental components of the Results Oriented Trust Environment in order to compare and contrast its provisions with standard approaches to trust construction:

A. It Is Primarily Discretionary

The Financial Skills Trust uses a discretionary framework that relies on the judgment of the trustee within the constraints and guidelines outlined by the settlor(s). It does so in a manner which clarifies how discretion may be exercised. The Financial Skills Trust avoids in various ways the problems of incentive trusts, absolute-discretion trusts, or trusts which use ascertainable standards with restricted definitions.

We have already outlined in prior sections why using an incentive-trust approach has significant limitations. Absolute-discretion trusts are convenient in their broad and largely unchallengeable latitude on the part of the trustee, but to the beneficiary these can seem arbitrary and potentially capricious. Trying to figure out the rules of the absolute-discretion often forces beneficiaries to become mind-readers, can easily evoke resentment, and generally feels like a perpetuation of the child-parent relationship. Trustees feel protected while beneficiaries feel controlled.

Discretionary trusts which use ascertainable standards with restricted definitions provide a seemingly better balance of clarity and flexibility. Unfortunately, this basis is not as objective as it is often made out to be[19] and provides ample opportunity for the beneficiary to game the system by always tying requests to some aspect of health, education, maintenance, or support. The trustee is continuously faced with either trying to figure out whether the request is legitimate and, if inclined to decline, must worry about the beneficiary using the courts to challenge the trustee's judgment. One of the co-authors recently encountered a situation in which a $64 million testamentary trust split equally between two adult beneficiaries authorized the trustee to invade principal under a slightly modified ascertainable standard which placed considerable emphasis on education. One of the beneficiaries requested a $5 million distribution from his trust to purchase a deep-sea-capable motor yacht on the grounds that a round-the-world cruise would be educational!

The Financial Skills Trust keeps the main benefits of flexibility and minimization of litigation risk of a discretionary trust but adds clarity of decision-making and accountability on the part of the trustee when dealing with the beneficiary.

B. Description of Settlor Intent

A key provision of the Financial Skills Trust is inclusion of a mission statement that lays out the settlor's views on the purpose of the trust, which would include the long-term focus on encouragement of positive money skills and financial behaviors, and the degree to which beneficiaries are to be encouraged to take risks as they grow into handling their money. Without a mission statement addressing these and related issues, both trustee and beneficiary must make guesses about the purpose of the trust, how discretion is to be exercised, and what the ultimate goals of the wealth transfer are supposed to be. With no clear statement of intent, the trust becomes a ship with a compass but no location of true North. As Ed Halbach, Jr. has commented, "*Too frequently the trust instruments provide no guidance as to the purpose and scope of the power. [The trustee] should be informed of the purposes of the trust, the factors he is to consider, and something of the general frame of mind in which the settlor wishes him to act*." Edward C. Halbach, Jr. *Problems of Discretion in Discretionary Trusts,* Col. L. Rev. Vol. 61, p. 1425 (1961).

Provisions within such a mission statement often include discussion of the settlor's values, the relative importance of philanthropy or social action as a part of a life focused outside the self, the encouragement of education or travel as part of an enriched life, and the role of the trustee to mentor the beneficiary in preparation for a fortunate life with substantial resources[20.] Other important elements may include how disagreements between the trustee and beneficiary are to be handled on a first-pass basis, the permitting of moderate risk-taking on the part of beneficiary's business or financial plans, a

19 See Gallo, J (2009) The Use and Misuse of Ascertainable Standards in Trusts, *Journal of Financial Planning*, December, pp. 32-34.

20 Hughes, J. (2004): The Trustee as Mentor (Chap. 19) in *Family Wealth: Keeping It in the Family*. New York: Bloomberg Press.

concomitant release of liability for the trustee for granting this latitude, and the recommendation for the beneficiary to read and understand the trust in order to be an informed beneficiary. Under the doctrine of incorporation by reference, the mission statement can also refer to and incorporate statements of intent that may reside outside the trust in written or recorded (video or audio) form provided they are identified with sufficient particularity.

An interesting issue is whether the trustee may – or perhaps should -- take into consideration statements of intent by a settlor that are written or recorded after the date the trust is executed. In a discussion of the appropriate test of a trustee's exercise of discretion, Scott & Fratcher, *The Law of Trusts*, section 187 (4th ed. Little Brown & Co. 1987) states that "the real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he would act." The quoted language appears to involve the intersection of the law of trusts with the estate tax laws. It raises the question whether the trustee of an irrevocable trust which grants broad discretion should, if the settlor is living, consult the settlor in an effort to determine whether an exercise of discretion is consistent with "that state of mind in which it was contemplated by the settlor that he would act." If the settlor does not retain the right to alter or amend the trust and the trust instrument does not provide exoneration or other liability protection for a trustee who exercises or refrains from exercising discretion after taking into consideration statements of intent that post-date the execution of the trust, such subsequently written or recorded statements would not appear to constitute a retained power under IRC Secs 2036-38 or a general power of appointment under IRC Sec. 2041. It would also appear that the provisions of such a non-binding post-execution statement of intent could properly be considered by the trustee in ascertaining "that state of mind in which it was contemplated by the settlor that he would act." This arguably provides a means by which the beneficiaries and trustees of an irrevocable trust may clarify issues about values, intent, or purpose that may evolve over time.

C. Use of behavioral guidelines focused on money skills

The unique contribution of the Financial Skills Trust is its inclusion of financial skill benchmarks within the guidelines for trustee discretion. Based upon the literature about financial literacy skills and our collective experience as wealth counselors and advisors, we have found that there are a core set of six interrelated, primary financial skills fundamental to prudent money management, along with a secondary list of two skills that are commendable but not crucial.

1. The ability to live within one's means, i.e., managing spending consistent with one's level of income;

2. The ability to manage spending relative to income in a manner that would be consistent with being able to save a portion of income, as needed;

3. The ability to understand and manage credit and debt processes, leading to avoidance of excessive debt;

4. The ability to maintain reasonable accounting of one's financial resources;

5. The ability to understand and manage one's personal assets, either using basic investment procedures and principles oneself or to delegate these actions responsibly to appropriate advisors; and

6. The ability to generate income for spending needs if additional resources are required or desired beyond trust distributions.

In addition, the following two skills are advisable though not crucial:

7. The ability to use of a portion of one's income and/or financial resources to support charitable activities of one's choosing; and

8. The ability to show initiative, engage in entrepreneurship, and demonstrate purpose in paid or unpaid work.

Detailing how these primary and secondary skills are implemented is crucial to understanding the Financial Skills Trust. We clarify and give examples of the use of these financial-skills criteria later in this Section.

D. Open Communication About The Trust So The Beneficiary Is Aware Of The Basis For Discretionary Distributions

Administration of this type of trust requires effective periodic communication between the trustee and beneficiary. This typically involves meeting perhaps annually or biennially to talk over the beneficiary's activities, goals, and skills and to maintain the relationship between the trustee and the beneficiary. The optimal situation involves collaboration and planning between the parties as well as looking ahead to understand the beneficiary's plans, review decision-making, and discuss any adjustments that may occur in the discretionary decision-making of the trustee based upon the pattern of beneficiary's skills.

Periodic meetings are also necessary for working out difficulties that may inevitably arise in the course of trust administration. The Financial Skills Trust focuses as much as possible on definable behaviors which are occurring to a greater or lesser degree in a manner consistent with financial self-management. If and when those behaviors are falling behind or insufficiently developed, leading to repeated requests for additional funds or more time to catch up to debt-management goals, the trustee is empowered to set timelines, offer educational or tutoring opportunities, or any other method that may facilitate the development of needed skills.

Ultimately, however, the fundamental aim of the Financial Skills Trust is not that the beneficiary develops financial management skills, surprising as that may seem. The fundamental aim is to focus on whether the beneficiary is avoiding financial problems – the *result* of having these skills. It is results-oriented in terms of how distributions or trusteeships are granted. If the beneficiary does not wish to grow or maintain financial self-management skills, that is the beneficiary's choice. What the Financial Skills Trust is clear about is that discretionary distributions, acceleration of mandatory distribution dates, or granting of co- or sole-trusteeships will not occur in the absence of observable demonstration of good financial skills. If a beneficiary is living within his or her means, avoiding excessive debt, knowing basically how much he or she has for income and expenses, etc., the beneficiary knows that the trustee is far more likely to make a discretionary distribution of income or principal than if the beneficiary is not demonstrating positive financial self-management skills. Such an approach encourages open, transparent and periodic communication about the match between the trust's provisions and the beneficiary's behavior, including any necessary limit-setting on the part of the trustee when results seem to be missing in the beneficiary's financial self-management.

¶ 1104.3 The Balance of Specificity, Autonomy and Accountability

The power of the Financial Skills Trust is not only in its focus on skills and their desired results. It is in what the trust does not do. First, it stays away from requiring vague personality-based qualities that may be desirable but are so subjectively defined as to invite a parental overly-judgmental attitude or abuse of discretion by the trustee. It seeks to be as operational as possible in order to minimize mind-reading on the part of the beneficiary and uncomfortable subjectivity on the part of the responsible trustee. Second, it avoids placing trustees in the inevitably futile position of trying to undo those failures of parenting or circumstance that created poor results in beneficiaries' self-management. Recall those frustrated comments in the beginning of this article by the ACTEC Fellows who were being asked by parents to devise incentive trusts to somehow rehabilitate errant beneficiaries long after the damage had been done.

Third, in our view the FST sidesteps the tempting but categorically flawed reasoning of incentive trusts that permits distribution of money to reinforce choices and behaviors that are not necessarily money-related. When money is used to reward choice of spouse or level of education, for example, there is no direct link between the money placed in the beneficiary's hands and the behaviors related to management of this money. Even when the trustee wishes to inculcate effective money skills, this is only done indirectly, such as in providing matching funds for whatever the beneficiary earns for income or for being able to hold and keep a job for defined periods of time. Money is used to reward an assumed *indicator* of having money skills, not the skills themselves directly. Because of this, beneficiaries often try to figure out how to game the system without really developing the skills. They learn how to satisfy the form but not the substance of the trust. This is once again a demonstration of learning how to respond to external motivations rather than being internally motivated to develop effective money skills.

Finally, the Financial Skills Trust avoids meddling with beneficiaries' life choices about career, spouse, place of residence, religious faith, level of education, or level of earned income, to name the most common decisions that settlors seek to control through incentive trusts. In doing so, the FST seeks to preserve that which is highly precious to most people in life: autonomy. It provides the best balance between the beneficiary's right to autonomy in one's personal life choices and the settlor's right to hold beneficiaries accountable to manage inherited assets prudently.

One could argue that any linking of trust money to the development of a set of behaviors in the beneficiary is inherently controlling. In truth, anything less than outright distribution of the settlor's=assets restricts beneficiaries' full autonomy to run their lives the way they wish to, including the right to be poor money managers in their own lives. As a general rule, competent adults are free to have poor financial judgment and mismanage their own assets without infringement by the state. The crucial difference is that neither trust income nor trust principal belong to the beneficiaries until distributed to them. A Financial Skills Trust acknowledges the settlor's right to have reasonable expectations that beneficiaries will manage distributions of inherited wealth in an accountable manner. Yet, it reminds the responsible settlor to exercise restraint in how far that control may go. A Financial Skills Trust is for the benevolent client who wants to help his descendants learn to manage money responsibly, not for the overly-controlling client who wants to micro-manage their lives and their decisions.

By using results-oriented criteria to evaluate beneficiaries' money skills, the Financial Skills Trust achieves many positive objectives. It provides clarity for both the trustee and the beneficiary. It is consistent with the use of money to reinforce behaviors that only relate to money, without trying to motivate other behaviors in ineffective and counterproductive ways. It balances beneficiaries' right to reasonable autonomy with settlors' reasonable expectations for accountability. And in encouraging (but not requiring) thoughtful financial self-management, it is consistent with fostering positive values conducive to a more happy and fulfilling life.

¶ 1105 Section 5: The Financial Skills Trust in Operation

The keys to drafting and administering a Financial Skills Trust are effective initial discussions with the settlor(s) and satisfactory descriptions of methods for evaluating evidence of financial self-management skills.

¶ 1105.1 Defining Settlors' Intent: What Results Do They Want?

Detailed communication between the settlor and the drafting attorney is fundamental to defining the basic parameters for how discretion will be exercised. We have found some of the most useful conversations about family wealth occur during the planning stages for a Financial Skills Trust. Part of the discussion is about the financial skills criteria the trustee is to take into consideration in exercising or declining to exercise discretion. But an equally important part of the conversation is in building the mission statement that frames the trust's objectives (the Results part of the Results-Oriented Trust Environment) in its opening sections. This is where settlors can expand on their values, the latitude they wish to grant the trustee in administering discretionary provisions, and more specific provisions about encouraging risk-taking in learning entrepreneurial activities or how to handle ambiguities that may arise. Settlors should be encouraged to keep the mission statement positive and aspirational, as their words may live for generations throughout unforeseen circumstances in a global world.

Vital to both the mission statement and the development of the financial-skills criteria is the drafting attorney's ability to engage the settlor(s) in the process of defining the results they not only want the beneficiaries generally to demonstrate but which can be specified behaviorally. This is often quite hard. Strong-willed wealth creators and their spouses commonly react to questions about defining work ethic, prudent spending, or debt avoidance with a "the trustee will know it when he sees it" or "it's obvious!" stance.[21] The estate planner may find it both necessary and helpful to point out the necessity of providing operational guidelines to trustees and beneficiaries who may not see things as clearly or intuitively as the settlor(s). One good method to get clients to think through what financial management skills are in daily life is to ask, "Give me an example of what that would look like on a day-to-day basis." Distilling noble but abstract and potentially judgmental concepts into guidelines for the trustee and beneficiaries is a skill the attorney must provide in crafting the Financial Skills Trust.

If at all possible, we recommend that settlors and estate planners include the named trustee(s) and responsible adult children in the process of defining the operational guidelines for the behavioral criteria. The trustees are able to watch and listen to the settlors and their children work through their thinking about the criteria, which should be documented in the estate planning file. Trustees and adult children can also contribute important perspectives about what may be implementable and what may be difficult to administer or explain to the beneficiaries. Some settlers are wary of including the future beneficiaries in this discussion for fear, as one client put it, of "having the inmates run the asylum." The estate planner can reassure the client that including beneficiaries in the discussion does not delegate away all decision-making to the beneficiaries, who in truth may seek to water down provisions they see as onerous from their current lack of skills. Settlors retain decision-making authority and may need to explain clearly to beneficiaries why they want to frame provisions a certain way. Nevertheless, a healthy and assertive discussion between settlor(s) and beneficiaries produces a more solidly-defined trust, relieves the trustee of the burden of having to explain things for the first time once the trust is in operation, and allows objections to be handled directly between settlor(s) and beneficiaries, which is where they should be.

¶ 1105.2 Understanding and Crafting the Financial Skills Guidelines for Discretion

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21 "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description ["hard-core pornography"]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that." Justice Potter Stewart, concurring opinion in Jacobellis v. Ohio 378 U.S. 184 (1964), regarding possible obscenity in The Lovers. While such a standard may work at the level of the Supreme Court it is rarely helpful for an embattled trustee!

The listing of primary and secondary skills for financial self-management set forth below often satisfy what settlors want to see in their succeeding generations. These skills seem to form the core of financial literacy, successful adjustment to wealth, self-discipline, prudent spending, charitable inclination, and purposeful life. The following is a discussion and exemplification of each of the skills:

A. Primary skills

1. The Ability To Live Within One Means, i.e., Managing Spending Consistent With One's Level Of Income.

This skill is the first leg of the stool which, along with its companion skills of saving and avoidance of excessive debt, represents effective management of one's financial life. If the beneficiary can master none of the other skills, the concept of living within one's means may be the foundation for staying out of trouble with money. It grows from the universal dictum that, above all else, one must manage one's spending in a manner not to exceed one's available resources. It is in violation of this principle that some beneficiaries over-reach their lifestyle, demand concessions and distributions from their trustees, and act (when accompanied by a sense of entitlement) in a way that is considered spoiled. Most trustees are familiar with overspending beneficiaries who routinely ask for distributions well in excess of their current income, including requests for distribution of principal in order to make up any shortfall between income and spending.

Where things get problematic for both settlors and trustees is in defining exactly what this means in ways that would be workable. Clarifying what "living within one's means" really looks like through the vagaries of daily life is difficult. For both the trustee and the beneficiaries, it must balance accountability with flexibility. Our experience is that, as settlors struggle with defining this in practicable ways (alongside discussions with the drafting attorney and perhaps the trustee and adult children in collaborative estate-planning family meetings), it is important to grant flexibility for short-term variations in spending that might exceed income within a particular year. Such variations include investing to develop a business, temporary setbacks in income derived outside the trust, or extra expenditures that occur upon moving to a new area or residence or that result from an illness or accident. The desire is to keep the beneficiary mindful that expenditures in excess of income are to be limited, so as not to create a chronic overspending problem. The more the trustee knows the beneficiary and the beneficiary can describe a reasonable decision-making process that justifies excess expenditures, the less problematic this skill is in trust administration.

It is this ability to describe and demonstrate a reasonable decision-making process in spending that is one of the core purposes for using behavioral criteria. Unlike the games-playing by beneficiaries involved in bootstrapping distribution requests so they somehow fit within the ascertainable-standard regimen, this criterion focuses on the results of the beneficiary's ability to demonstrate the complex decision-making inherent in living within one's means over a period of years.

This guideline looks solely at the match between income and spending. It does not make value judgments about the appropriateness of spending choices, how the beneficiary chooses to use trust income versus other earned or unearned income, or any other determination about the beneficiary's lifestyle. If the beneficiary is a school teacher who makes $50,000 a year and receives another $50,000 a year from a trust, he has a gross income of $100,000. The only question is whether expenses, including taxes, are more or less than $100,000 a year. If the beneficiary is an investment banker and earns $900,000 a year and receives $50,000 a year from a trust, the question is whether expenses, including taxes, are more or less than $950,000 a year. The second beneficiary may have adopted a lavish lifestyle the trustee or settlor may not approve of, but so long as she is not spending more than $950,000 a year, she is living within her means and has an important life skill.

At its simplest, living within one's means can be defined as not spending more than one's income from all sources, whether earned or derived from the trust or other sources. In financial terms, this translates to spending at or less than 100% of one's net income after taxes in a given year. In order to provide flexibility, this could be drafted as "spending is not to exceed 110% of income a year for a two year period" or some similar criterion.

It is important to define the term "income" since, using this benchmark guideline, there is incentive to over-report income rather than the more usual games-playing of under-reporting income. If a beneficiary has $70,000 of earned income and $65,000 of spousal income, derives $50,000 from his trust, but pays $50,000 of taxes at all levels, he has gross income before taxes of $185,000 and net income after taxes of $135,000. This beneficiary can spend up to $135,000 per year and be living within his means. Invasions of principal – such as savings – should not be included in the definition of income. It would be up to the settlor and the drafting attorney to determine whether, and if so, what percentage of capital gains are included in the definition of income.

The more problematic issue is under-reporting of spending. Some typical means of documenting spending are bank account and brokerage account statements, tax returns, and related bookkeeping documents that the beneficiary submits for trustee review. However, as will be seen below, excessive spending most often occurs by tapping credit sources, so a review of credit card statements, loans, and – most efficiently - credit reports often reveals beneficiaries' attempts to maintain a lavish lifestyle, more than a simple review of income and spending documentation. Although requiring such detailed documentation is invasive of the beneficiary's privacy, there is no other reliable means by which the trustee may in fact determine if the beneficiary is in fact living within his means. The trust instrument should provide that a beneficiary requesting a distribution shall, if requested by the trustee, provide such documentation (including the above listed credit reports) as the trustee may reasonably request. The trust instrument should provide not only that such information is to be held in strict confidence by the trustee but also for the removal of a trustee who does not maintain such confidentiality

Criteria for the permissible level of mild overspending may depend on the size of the trust. Let's look at a 110% maximum spending criterion for three different trust asset levels: $130,000, $1.3 million, and $13 million:

(i) For a $130,000 trust corpus generating a 4% income distribution per year, the beneficiary receives only $5,200 a year. In most circumstances, the beneficiary will clearly need to have other income from a job, a spouse/partner, rental property, or other means in order to support himself or herself. Whatever spending is done by the beneficiary will need not to exceed all sources of support beyond the 110% criterion. The trust income is only a small part of income.

(ii) For a $1.3 million trust corpus generating a 4% income distribution per year, the beneficiary receives $52,000 a year. The beneficiary may spend within this level, which represents close to the median US income level per year. Otherwise, if more spending is desired, then he or she must bring in income via other sources. A 110% criterion would allow spending up to $57,200 within a defined period of time, e.g., two consecutive years, which means the beneficiary must either request a very small amount of additional money from the trust or take on debt or draw from savings (which may then impact those guidelines on a short-term basis). This is not unreasonable on a short-term basis if the beneficiary has significant extra needs.

(iii) For a $13 million trust generating 4%, the beneficiary receives $520,000 per year. A 110% threshold in this case allows up to $572,000 per year, or an additional $52,000 (presently about the cost of a mid-size BMW or one year of private undergraduate education). Two years' overspending at this level approximates an extra $100,000 in spending which many reasonable observers (and settlors) might consider a harbinger of not living within one's means. If a beneficiary earns $125,000 through a job or consulting and receives $520,000 from trust income, she is free to spend up to whatever net income is available from $645,000 per year. This is not being a spendthrift – it is spending within one's means.

In operation, many trustees and beneficiaries should find this guideline reasonably straightforward to administer despite the many objections and what-if scenarios that can be envisioned beforehand by the worried settlor or harried trustee. With a relatively clear benchmark and commonsense trustee guided by the mission statement of the settlor within the trust document, evaluation of the beneficiary's spending skills leads to a general sense of whether the beneficiary is achieving the desired result, or not. Truly problematic beneficiaries don't overspend occasionally by 10% beyond their income; they spend well past that threshold on a continual basis. In such circumstances, the trustee must be able to discuss with the beneficiary whether no further discretionary distributions will be forthcoming or some other consequence will occur. The trustee is free to look at the totality of the beneficiary's financial skills, then to exercise judgment and discretion within the purview of the trust provisions.

2. The Ability To Manage Spending Relative To Income In A Manner That Would Be Consistent With Being Able To Save A Portion Of Income, As Needed

"Living within one's means" can still mean living paycheck to paycheck, or trust distribution to trust distribution, without the cushion necessary to deal with unforeseen expenses or opportunities. The second leg of good financial management requires the maintenance of some level of reserves that can be tapped and replenished. To achieve a financial result of saving some portion of earned or unearned income, one must employ a variety of skills. These include the ability to make choices that defer spending in order to create or maintain a financial reserve, delay immediate gratification, and resist the impulse to spend whatever one has started to save. It also requires restraint and forethought to replenish savings that have been drawn upon, thereby keeping the reserve available for the next event.

Many beneficiaries come to see their trust as their retirement savings account, which may be true if the trust corpus is sufficiently large. The trust presumably is replenished not by the beneficiary but by its growth through investment, unless tapped to such an extent by the beneficiary that a drawdown of principal exceeds the growth of the trust assets. There are three levels of "savings" management, therefore, that can occur by the behavior of the beneficiary and the permission of the trustee:

(i) The beneficiary lives somewhat below his/her means of total income, creating a personal reserve tapped as needed without turning to the trust for money beyond normal distributions.

(ii) The beneficiary requests distributions from the trust as if it were a savings account, but draws less than or equal to the average growth of the trust assets via investment.

(iii) The beneficiary uses the trust freely as a financial reserve to an extent exceeding appreciation in principal and thereby diminishes the trust over time.

Unless the intent of the settlor is for the trust to act as a personal savings account for a struggling beneficiary and the interests of remainder beneficiaries are not to be considered, option (iii) is not desirable and represents overspending. It is the result of ineffective financial skills on the part of the beneficiary and ineffectual limit-setting on the part of the trustee. Option (ii) is risky but not unreasonable with a good-sized trust and investment growth. Option (i) is the best demonstration of financial skills and, in a sense, of autonomy.

Demonstration of the skills of being able to create and maintain a financial reserve depends once again on the circumstances of the trust and the beneficiary's other assets or income. Let us look again at the three examples of trusts described above:

(i) A $130,000 trust – This generates a low level of income and is too small to serve as a long-term savings vehicle if tapped aggressively. A good result of a beneficiary's financial self-management would be development and maintenance of a financial reserve outside the trust that smoothes out the income/spending discrepancies everyone experiences over time. Looking to the trust to support all unforeseen events reflects abrogation of both the beneficiary's and the trustee's responsibility to help steward the small resources of the trust for good long-term support, unless of course the intent of the trust is to provide short-term support that will be depleted over time.

(ii) A $1.3 million trust – At this level, a trust that is intended to provide income and principal support over a period of many years or decades may serve as a savings vehicle but will require careful stewardship by the beneficiary and trustee not to deplete the trust through repeated distributions of principal. Beneficiaries at this level may often ask, "Why do I have to maintain any savings? The trust is my savings." A helpful answer is to reread carefully the exact wording of this guideline. The aim is to have the skill to manage spending *in a manner that would be consistent with being able to save*, not necessarily to create savings. Trustees should look for beneficiaries' ability to describe decision-making necessary for adjusting spending in a manner that takes into account circumstances such as unforeseen or unusual expenses, timing of upcoming income (with delay of spending as needed), and the need to weigh priorities so necessity spending is preserved while optional spending is deferred. Also as mentioned above, trustees may assess whether the beneficiary sees credit cards or loans as surrogates for savings – not unlike many in the American population – rather than viewing financial reserve accounts as savings.

(iii) A $13 million trust – At this level, the trust can legitimately be considered to be the beneficiary's retirement fund and savings account unless plundered through excessive distributions of principal. In a sense, a 110% criterion for spending allows for a 10% tap periodically into the trust as if it were a savings account, particularly if this happens only in some years and allows for replenishment of the trust principal via investment management. The key in this situation is whether the trustee sees a consistency in spending by the beneficiary over time in a manner that reflects prudent stewardship of the trust itself. Just as middle-class wage-earners must manage the ebb and flow of their savings account carefully, choosing when to access it and when to replenish it, beneficiaries who exhibit this financial skill participate in the careful harboring of their own trust assets and do not expect the trustee and wealth manager to do it all for them.

3. The Ability To Understand And Manage Credit And Debt Processes, Leading To Avoidance Of Excessive Debt

This guideline represents the third leg of the stool that is good financial self-management. Prudent spending and stewardship of savings stand or fall by whether one treats credit availability as a means of facilitating overspending and/or a substitute for savings. It is rare to find an overspending beneficiary who doesn't also mishandle credit.

Whether individuals get into trouble with excessive debt due to poor financial management skills is partly a function of the asset level under their direct control. Middle-class or upper-middle-class beneficiaries may burn through their income and available personal assets while also accessing loans, credit cards, and lines of credit to support their lifestyle until bankruptcy finally looms. Beneficiaries of moderate trusts may be rescued periodically from debt by distributions, particularly under an ascertainable-standard provision, until their trust is depleted or the trustee draws a line in the sand. Beneficiaries of larger trusts may still run the risk of trust depletion but the term "excessive debt" may not come into play until near the very end. The trustee, therefore, must always look at the beneficiary's credit management behavior.

Many of the ways by which individuals normally accrue excessive debt may not be typical for beneficiaries of trusts beyond a certain size, within the broader context of significant family wealth. For example, large student loans or catastrophic medical expenses (particularly due to not having medical insurance) are rare with beneficiaries of significant trusts because education and health expenses are paid by the trust or by gifting for educational or medical expenses rather than by the individual.

A Results Oriented Trust Environment makes no value judgments but simply looks at results. Accordingly, the role of the trustee of a Financial Skills Trust is to monitor the credit behaviors of beneficiaries in order to evaluate whether or not credit is being used to finance their lifestyle by end-running imprudent spending and lack of saving. Operational criteria can be written into the trust guidelines in several ways. One is to specify a debt-to-income ratio not to exceed a certain level, a minimum FICO score or credit rating, or a level of debt service that remains proportional to income or assets up to a specified range.

4. The Ability To Maintain Reasonable Accounting Of One's Financial Resources

The first three guidelines are all part of the beneficiary's ability to budget. Another skill inherent in successful budgeting is the ability to keep track of one's finances. How can an individual live within one's means if there is no general tracking of income and outgo? How can one manage savings or credit effectively without even a rough idea of the amounts owed, when and how large a payment is due, or whether an expenditure can be funded from a given account?

Being able to keep track of one's finances seems deceptively simple and obvious to anyone who is financially literate. Yet this skill is often absent in those who overspend or, at the other end of the spectrum, are passive, avoidant of wealth, or guilty about its responsibilities. The cluelessness of many beneficiaries about their own finances helps either keep them dependent on advisors or living in a constant state of anxiety, shame, or guilt. It also contributes to financial mistakes. Knowing and monitoring one's finances is not only helpful for effective self-management; it can be one marker of a positive adjustment to wealth. Knowing what you have requires facing what you have, not turning away and hiding.

Like any skill, there are degrees of ability in tracking one's finances. A trustee doesn't need to hear from a beneficiary the exact balances of every account from memory in order to be reassured this skill is present, nor to hear that the beneficiary's checkbook is balanced to the penny each month. Many if not most settlors could not pass such a test themselves. To satisfy this guideline, beneficiaries need to be able to demonstrate they have a reasonable grasp of their assets, the relative size of their main accounts, and the basic parameters of their monthly or quarterly expenses and income. This can occur during an interview with the trustee that covers updates on recent activities, upcoming plans, and discussion of other guideline criteria such as job status and philanthropic activities. Asking the beneficiary how he or she keeps track of finances provides insight into whether the beneficiary is using reasonable methods for tracking finances or the procedures are haphazard. Furthermore, demonstrating effective budgeting skills overall is a general result that follows from at least some level of personal financial literacy.

5. The Ability To Understand And Manage One's Personal Assets, Either Using Basic Investment Procedures And Principles Oneself Or Delegating These Actions Responsibly To Appropriate Advisors

Beyond maintaining effective financial self-management through basic budgeting lies the next level: actually managing one's money effectively. With small trusts producing limited income for a working-class or middle-class beneficiary, there may not be much personal money to invest or grow, so this skill may be moot. However, for beneficiaries with significant assets accrued through unearned and earned income, a useful financial skill is to know at least the basics of investing.

The standard for this level of skill is *not* to be on par with professional money managers. The level of investment expertise in the general population is far from this level. Nor must beneficiaries be required to avoid all the errors of behavioral finance the average investor is prone to make. Estate planners may have to remind the overzealous settlor that the benchmark for all future beneficiaries is not the wealth creator who founded his own investment management company. The guideline is simply to be able to manage one's extra assets with average attention to risk, asset allocation, and market conditions using the multitude of investment vehicles available to the general public. Examples include maintaining and directing an institutional or online brokerage account, investing with mutual funds, or using a local bank's investment services.

This guideline allows for beneficiaries who prefer not to learn these skills themselves to delegate this area to a professional manager. Requiring that investment expertise be fully vested in the beneficiary ignores the reality that many people have little ability and less inclination to do their own investment management. Assets may be more at risk from the self-managed but inept beneficiary than from the wise delegation of this function to a well-chosen financial professional.

The trustee administering a Financial Skills Trust can be very helpful to the beneficiaries by discussing the pros and cons of investment education and self-direction, assisting in the decision to refer some or all of the beneficiary's money management to an advisor or firm. This is also not necessarily a one-time discussion. Beneficiaries who are young, focused on other things, hesitant, or afraid of the full responsibility of investing may initially rely on professional management. Later when conditions or emotions change, the beneficiary may decide to learn about investing and take on at least some of its activities. We have often seen inheritors start from a position of avoidance or ineptitude about their own finances and make excellent progress toward self-efficacy and self-sufficiency. There are resources on the market by wealth coaches and counselors that provide both emotional support and basic financial training for inheritors who seek to grow in this manner[22].

However, those beneficiaries who do choose to delegate financial management to advisors need to have certain skills to do so effectively. Simply hiring an advisor and turning everything over with no further participation or interest is not a skill; it is a risk. Working effectively with advisors is a set of abilities in and of themselves. Component activities include attendance at scheduled meetings, timely responding to requests for signature or answers to accounting questions, collaboration in developing necessary documents such as investment policy statements, and participation at personal or family meetings in which legal or financial information is discussed. The trustee may interview the beneficiary about these activities and, if collateral or corroborating information is necessary, releases may need to be obtained for the exchange of information with accountants or financial advisors.

Administration of Financial Skills Trusts with these provisions may be convenient when wealth management and trust administration are under one roof. Trustees may know about the beneficiary's skills with self-management or collaboration with advisors because everything is managed in-house, as with corporate trustees with private banks or family offices. For diversified services distributed among various outside professionals, trust administration will be more cumbersome but may proceed adequately if collaboration among advisors and the beneficiary is well-crafted.

6. The Ability To Generate Income For Spending If Additional Resources Are Desired Beyond Trust Distributions

This guideline essentially reminds the beneficiary that, if he or she wants more than is being provided by trust distributions, the beneficiary needs to earn it. Again, this is intuitively obvious to anyone raised in the working world or who does not rely on trust income for sole support. Yet it is a useful reminder to the beneficiary that this is an expected financial skill. It is a companion to the skills expressed in guidelines 2 and 3 which reinforce that, if the beneficiary wishes to spend more than available trust income, he should not tap savings or credit sources; he should earn the additional money.

Unlike incentive trusts which take a carrot/stick approach to getting a job, the Financial Skills Trust frames this as a useful skill of adult life and financial self-

22 Two excellent examples by wealth counselor Myra Salzer are *The Inheritor's Sherpa: A Life-Summiting Guide for Inheritors* (Boulder CO: The Wealth Conservancy, 2005) and *Living Richly: Seizing the Potential of Inherited Wealth* (Boulder CO: Legacy Press, 2010).

management. The beneficiary doesn't have to get a job if he/she doesn't wish to. That is the beneficiary's prerogative. The beneficiary has the autonomy to decide whether, how, and at what he/she wants to work. If the beneficiary does not wish to get a job yet still lives within his/her means, maintains some method of buffering the variability of income and expenses via savings, and avoids tapping credit to support his/her lifestyle, the beneficiary is demonstrating good results in the other guideline areas the trustee will be taking into account in assessing the beneficiary's financial skills.

We defer to guideline 8 the broader encouragement to work which is based on the utility of having purpose in life and in one's daily activities. Remember, the Financial Skills Trust avoids making judgments and incentivizing noble but abstract and voluntary behaviors through extrinsic motivators. Guideline 6 is solely focused on the financial skill which says, *if you need more money*, you should know how to get and keep a job at whatever income level you feel you need. It recognizes that having a job requires a set of skills: finding available jobs, interviewing successfully, being on time and reliable, getting along with coworkers and supervisors, and the many other components of successful employment. It does not take for granted that beneficiaries automatically have these skills, since experience has taught many a trustee that these skills are rarer than one would expect. Just like the ability to track and account for one's income and outgo, this guideline states what may be obvious but is actually a skill.

The trustee evaluates the level of skill with this guideline by the usual results of employment. A low level of skill is reflected in spotty job histories, frequent failures to obtain a job or keep it, and difficulties getting along with people so firings occur on a regular basis. A moderate level of skill is reflected in better job maintenance but perhaps at lower levels than the beneficiary's intellectual potential or capacity for effort. One example is the beneficiary who periodically attempts to get a job -- but is not always successful in doing so -- to supplement trust distributions for specific purposes but, when achieving such employment, drops the job when the need has passed. Another example is the college-educated beneficiary who, despite being qualified for higher-paying employment and the employment is available, works at a minimum-wage job in order to make just enough to pay his/her bills and nothing more, and who regularly turns to the trust for extra distributions. Of course, if such behavior is the result of physical or psychological issues, the trustee would take such factors into consideration. A high level of skill with guideline 6 is manifested by stable long-term career employment that provides enough income to supplement whatever the trust does not cover.

As we have pointed out, a beneficiary who intentionally adopts a standard of living that does not require funds in excess of trust distributions and who manages his/her financial life effectively is exhibiting the other primary financial skills. We cannot emphasize enough that guideline 6 is focused on an additional skill (being able to get and keep a job) that is necessary only if the beneficiary desires to maintain a standard of living at a level beyond that which would be provided by trust distributions and other available unearned income such as spousal income. It does not directly reward the positive moral and psychological values inherent in keeping a job, since that is using money as an extrinsic motivator to try to accomplish what should be internally motivated.

It only focuses on the utility of being able to earn money when the beneficiary wants or needs to do so.

We also point out that guideline 6 is the opposite of provisions like the ascertainable standard, where the beneficiary struggling to get or keep a job is able to press for trust distributions in order to subsidize those vague constructs of health, maintenance, welfare, or support. Many a beneficiary blames the job market, scarcity of "appropriate" job openings in his or her chosen line of work, coworkers, supervisors, customers, transportation breakdowns, or other factors for the result of not having a job.

The Financial Skills Trust focuses not on the reasons for but the results of the beneficiary's activities. The trustee is certainly granted discretion to evaluate the legitimacy of the beneficiary's explanations for difficulties with job maintenance. But over time the onus is on the beneficiary wishing to enhance his/her standard of living to find ways to achieve the results of having a job, namely, earned income in addition to trust distributions. The burden is not on the trustee to provide income to a beneficiary who wishes to maintain a standard of living higher than that which may be achieved solely based on trust distributions.

The trustee must obviously take into account disability factors with a truly impaired beneficiary. Beneficiaries with limited job opportunities due to intelligence or documented infirmity would be evaluated with a lower expectation level than an able-bodied and –minded individual. As with any trust including those using an ascertainable standard, this is a potential area for games-playing by a manipulative beneficiary. However, the Financial Skills Trust has a key advantage. It deems supporting oneself at a standard of living in excess of what can be expected based on trust distributions to be optional. The beneficiary is always free to adopt a lifestyle within the constraints of trust distributions. For beneficiaries seeking to maintain an enhanced lifestyle, the Financial Skills Trust is *skills-based*; e.g., if jobs in one's field are not plentiful, the beneficiary learns the real-world skill that one sometimes takes other jobs on an interim basis in order to support oneself, or one learns new or better job skills through coaching. The Financial Skills Trust is *results-oriented;* it is the beneficiary's and not the trustee's responsibility to figure out what to do to if the beneficiary wishes to maintain a lifestyle in which spending exceeds trust distributions.

The trust is not used to incentivize getting a job through the common tactic of matching income. The trust does not reward certain types of job or salary levels more than others in order to jumpstart intrinsic motivation by extrinsic means. The trustee merely looks to see how well a beneficiary seeking discretionary distributions is demonstrating financial self-management by getting, keeping, and perhaps advancing in a job. Beneficiaries who exhibit these skills then enjoy the benefit of the trustee's collaboration, favorable exercise of discretion, and willingness to grant distributions or trusteeship powers under the terms of the trust.

B. Secondary skills

If beneficiaries demonstrate most of the six primary skills, they will achieve the positive result of competent personal financial management. They will spend within their means, have some method of savings behavior that manages inevitable short-term mismatches between income and expenses, handle credit effectively, keep basic track of their finances, be responsible investors for whatever assets are under their control, and be able and willing to earn income if they need to have more money than the trust distributes.

This situation alone should gladden the heart of most settlors and all trustees. Beneficiaries would in fact be functioning at a level superior to many individuals in the general public, given the sad data on personal financial literacy and financial planning. There would be fewer fights with trustees over discretionary distributions. Litigation would be decreased. Trust assets would be stewarded well, since excessive draw-downs on principal would be limited to unusual or truly dire circumstances. Intrusions into beneficiaries' autonomy would be minimal since they would be left to determine however they wish to spend their time, their money, and their interests. What more could benevolent grandparents or parents want for their succeeding generations?

There are two sets of behavioral skills that many settlors do want to at least acknowledge, if not encourage, as noble principles or markers of maturity in a purpose-driven life. Much like Maslow's hierarchy of needs which ranges from basic physiological needs to self-actualization, the Financial Skills Trust allows for a level above just the basic financial skills of life. It can step carefully toward aspirational principles that reflect a higher level of financial awareness and purpose.

Guidelines 7 and 8 still stay close to the two core tenets constraining the six primary skills. They focus on money and do not stray into nonfinancial areas such as religion, type of career, level of education, choice of spouse, or the myriad other choices a settlor may wish to control from the boardroom or the grave. They also try to remain as operational and nonjudgmental as possible, though this is much more difficult than with the primary skills. Being more value-driven, these two secondary guidelines are more inherently abstract and therefore subjective on the part of both trustee and beneficiary. As long as settlors, trustees, and beneficiaries are honest about the aspirational nature of these two guidelines, the result is that beneficiaries have a better life, society benefits, and wealth creators' best intentions for their legacy assets may be fulfilled.

7. The Ability To Use A Portion Of One's Income And/Or Financial Resources To Support Charitable Activities Of One's Choosing.

The six primary skills focus on the beneficiary's own life. Guideline 7 recognizes the value of focusing on others as well, as a desirable behavior that is both ennobling for the individual and beneficial to the world. Philanthropy is often listed in financial literacy education as a core behavior that requires attention, skill, and decision-making, just like the primary skills. Philanthropy also reflects values that settlors may want to pass on as part of legacy. These values include altruistic focus and behavior, restraint in spending in order to devote money to others rather than only to oneself, and activity performed with like-minded people to advance a shared cause. It can be consistent with religious faith, or it can be simply a set of values a beneficiary deems virtuous in and of itself.

Charitable activity has levels of interest and ability just as in any other skill. Little philanthropic skill is demonstrated in the rare writing of a check made in reactive response to a plea for donation. Truly low skill is charity poorly done – getting taken in scams, overly generous donation as a result of undue influence or naiveté, mismanaging grant-making, perhaps even chronic disorganization in keeping track of donations for tax purposes. Average skill might be considered what most people have. Donations are made largely in response to requests rather than in a purposeful way that reflect one's values and interests with selected causes. Charitable donations may be largely tax-driven and cluster in that year-end range charities know to target.

High skill may represent clear philanthropic interest and ability. The beneficiary may have well-defined charitable interests funded in consistent ways using organizations that are efficient and effective. The philanthropy may be backed up by social actions utilizing the beneficiary's time and talents, not just money. The level of donation may be above average and beyond what is allowed just for tax deduction purposes.

What if a beneficiary is also a foundation board member who is actively engaged in philanthropy using the foundation's assets rather than his or her personal assets? Must the beneficiary in a Financial Skills Trust maintain active philanthropy outside of foundation responsibilities in order to demonstrate independent skill and commitment? This is a question for discussion between settlors and estate planners. For many settlors, the beneficiary who participates meaningfully in formalized philanthropic activities (particularly in family foundations) will satisfy this guideline. Some settlors may wish to specify a level of personal activity or some degree of independent skill outside of foundation work, in order to avoid having beneficiaries offload a great deal of their philanthropic involvement to foundation staff. Simply showing up quarterly to vote on grant making recommendations by others may be commendable but is of only modest skill. But it may nevertheless satisfy the intent of the settlor that the beneficiary participates in social action, community activity or philanthropic support. In general, a beneficiary who demonstrates skills with charitable activity and/or social action in the causes of his or her choosing achieves positive results in the context of the results-oriented environment of the Financial Skills Trust.

However, Guideline 7 in a Financial Skills Trust should be carefully crafted to adhere to the core principles of avoiding judgment and supporting the autonomy of the beneficiary. Philanthropy is a noble activity which, in operation, has been dragged deeply into pain and strife within many families of wealth. Wealth creators tend to feel very possessive of how their hard-earned assets are used to benefit the world. They may want to dictate when, where, and how their money is to be used by next generations as part of charitable activities, let alone social action that aggressively supports political or religious causes. The next generation may be saddled with constraints which may undercut any joy or sense of personal purpose in philanthropy. As Jay Hughes has commented[23,] the next generation must find and fulfill its dreams, separate from the dreams of parents and grandparents. Not all settlors want that.

Guideline 7 therefore focuses on whether and how well a beneficiary is engaging in philanthropy or social action, not whether the settlor would have approved of the cause. To do anything less is to start down the slippery slope of defining what is *appropriate* philanthropy, not what is philanthropic skill, behavior, or success. Settlors creating a true Financial Skills Trust may need to accept that trustees will focus on whether the beneficiary demonstrates the component skills of philanthropy, agnostic of the philanthropic focus.

In operation, we have found that Guideline 7 can be as hard to craft as Guideline 1 which focuses solely on spending level and not the appropriateness of spending choices. Settlors must look within to see how much they genuinely want to support the behaviors of philanthropy and not the object. The same is true of trustees, who may be in the position of administering trusts with beneficiaries having very different views than the trustee but who fulfill the true meaning of philanthropy. For families with open governance policies and multigenerational family meetings, one of the most lively yet ultimately productive conversations is the facilitated discussion of Guideline 7 across multiple generations. Through active dialogue, families can come to a shared understanding of what the family legacy will truly be – fully self-directed philanthropy, or philanthropy with strings attached. This is a healthy discussion which also provides context for future trustees in administering the family's trusts.

Within a Financial Skills Trust, settlors may still outline their wishes for philanthropic activities as part of the statement of intent or mission statement. These can be encouraging or aspirational from the settlors' perspective, and they can serve as guidelines for the trustee to consider alongside the behavioral guidelines in the discretionary provisions. If so, we recommend that statements of the settlor's philanthropic intent be included in the mission statement and the behaviors of philanthropy in the discretionary provisions. This allows settlors to specify their values and their wishes for the use of their money while still providing beneficiaries with autonomy in their use of legacy assets.

Drafting attorneys can also remind settlors that another place for defining and enforcing philanthropic purpose is in philanthropic vehicles, not discretionary trusts. Foundations can have mission statements as narrowly-defined as their creators may wish. Board members can and should be constrained to administer foundation assets in a manner consistent with the foundation's purpose. This allows wealth creators oversight of their legacy assets more appropriately than through control of trust beneficiaries' behaviors.

8. The ability to show initiative, engage in entrepreneurship, and demonstrate purpose in paid or unpaid work.

23 Hughes, James E., Jr. (2007): *Family: The Compact Among Generations*. New York: Bloomberg Press.

Guideline 8 is the hardest to define and evaluate of the behavioral skills, yet it comes up so often in conversations with settlors that it deserves a place on the list. Just as Guideline 7 advocates for the beneficiary to have charitable skills, Guideline 8 advocates for a life with purpose.

This guideline is a companion to and expansion of guideline 6, which asks whether the beneficiary simply can get and keep a job if he or she needs extra money beyond trust distributions. Successful demonstration of guideline 6 may help keep a beneficiary out of financial trouble. Success with guideline 8 may help the beneficiary achieve a purposeful life.

Compared to the beneficiary who takes low- to mid-level jobs just to earn some extra income, the beneficiary showing guideline 8 may demonstrate some or all of the following:

i) employment that has a career focus where jobs are consistent with education and training

ii) the employment shows goal-oriented advancement

iii) professional activities are pursued in service of and consistent with job interests and skills, e.g., the beneficiary attends conferences in the field, reads professional or trade journals, and makes contributions to the field or industry

iv) significant time is devoted to professional activities compared to personal activities such as travel or entertainment

v) performance is recognized by the employer or professional organization through honors or promotions

Some beneficiaries have sufficient trust income and distributions that paid work is optional. Those demonstrating skills with guideline 8 may therefore choose to devote their time and energy to positions that pay little or no salary. Yet these beneficiaries clearly show a purposeful focus with an emphasis on achievement and initiative. Examples include the deeply devoted and active philanthropist who works hard on behalf of a foundation or cause, or the person who expends significant effort and initiative on one or more community services or social action groups. These individuals may advance to responsible positions, just as if they were promoted to an executive job in a privately-held or publicly-traded company. The benchmark therefore is not whether the beneficiary has a paid job; it is whether the beneficiary engages in purposeful activity.

A related but separate aspect is the weight given to *entrepreneurship* as a benchmark for purposeful activity. Many responsible individuals with purposeful activity are highly motivated and demonstrate work ethic and initiative, yet they are not creative in a business sense. They support the activities of others who may be more entrepreneurial, helping grow effective ideas into successful products or services through collaboration and teamwork. Wealth-creating entrepreneurs often confuse work that is successful with work that is entrepreneurial. They also may rate entrepreneurship as of the highest value, when other people may not. Entrepreneurship in purposeful activity may be considered a positive factor by trustees in evaluating guideline 8, yet it may be important not to require entrepreneurial mindset or skills as the main criterion for this guideline.

¶ 1106 Conclusion

Major studies in the field of motivational psychology over the last forty years call into question the underlying assumption on which incentive trusts are based: namely, that money can be used effectively to motivate future generations to become responsible money managers. Such studies suggest that focusing on the processes by which the beneficiary is assumed to become a responsible money manager – such as graduation from college or earning increasing amounts of income and hence becoming eligible for income matching – is not only unreliable but often irrelevant to the goal the trust intends to promote. The concept of the Results Oriented Trust Environment, in which the Financial Skills Trust is created, offers an alternative approach to encouraging responsible money management by placing the emphasis on the goal the settlor wishes to encourage – responsible money management – and not on the processes by which the beneficiary is assumed to achieve the goal.

As estate planners, psychologists, and consultants to families of wealth, we believe this approach provides a better balance of accountability, autonomy, transparency, and specificity than the all-too-limited benefits of incentive trusts. We encourage other advisors to offer this methodology to the many settlors, trustees, and beneficiaries who struggle to find such a balance in their estate planning, and ultimately in the family legacy.

¶ 1107 Sample Language

To my descendants and their Trustees, both living and those to be conceived and born in the future:

On the most basic level, the purpose of this trust is to further the pursuit of happiness by my descendants. I use the phrase the pursuit of happiness in the same way as our Founding Fathers used it in the Declaration of Independence. Neither they nor I were or are taking about acquiring more material goods or taking longer vacations but rather the sense of self-sufficiency that is derived from becoming self-reliant and financially sound, having a sense of emotional, social, and mental competence and giving back to the community.

The money in this trust will help make things more convenient for my descendants but it cannot make them happy. I believe that the family's money, including the money in this trust, should be viewed as a tool to support the growth of the family's real capital, *which consists of the family members and their knowledge achieved through life experience and education. This is why I believe that travel, involvement in philanthropy and education to one's maximum potential are so important.*

The trust is designed to provide my descendants with the opportunity for a paced introduction to and education in the capable and responsible ownership of wealth.

Until a beneficiary attains age twenty-five (25), the Trustee shall pay to the beneficiary, by distributing such sums to the Guardian of his Person, any fit person with whom the beneficiary resides, or to the beneficiary, or apply for his benefit, as much of the net income and principal of the trust estate as the Trustees consider reasonable and necessary to provide for his education, support, and his medical, dental, hospital and nursing expenses and expenses of invalidism. Any income not so distributed shall become principal.

Once the beneficiary attains age twenty-five (25), the Trustee shall pay to the beneficiary each year a unitrust amount from the beneficiary's trust equal to three percent (3%) of the net fair market value of the assets of such trust valued as of the applicable Valuation Date (the "Unitrust Amount"). The Unitrust Amount shall be paid in four (4) equal installments, payable at the end of each calendar quarter, from the net income of the trust and, to the extent such income is not sufficient, from principal. Any net income of the trust estate for a taxable year in excess of the Unitrust Amount shall be added to principal. "Valuation Date" means the first business day of the applicable taxable year of the beneficiary's trust. The taxable year of the trust shall be the calendar year.

The Independent Trustee may distribute to the beneficiary, in addition to the Unitrust Amount, such sums from the beneficiary's trust as the Independent Trustee determines, in the Independent Trustee's sole and absolute discretion, to be reasonably appropriate and consistent with the purposes of the beneficiary's trust, as explained in this Article.

In determining the unitrust amount payable to the beneficiary, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the beneficiary's death. Notwithstanding the foregoing, in the year in which the beneficiary's death occurs, the Trustee's obligation to pay the unitrust amount shall terminate with the payment immediately preceding his or her death.

If any unitrust payment is incorrectly determined, then the Trustee shall pay to the beneficiary, in the case of an undervaluation, or the beneficiary shall repay to the trust, in the case of an overvaluation, an amount equal to the difference between the amount actually paid and the amount which should have been paid. Such payment shall be made within a reasonable period after the final determination of the correct unitrust amount.

As used herein, the term "medical, dental, hospital and nursing expenses and expenses of invalidism" include distributions for physical, mental, emotional, and health *needs. Health needs include health insurance and therapy, both physical and psychological/emotional, as well as expenses of cosmetic surgery.*

As used herein, the term "education" means elementary and secondary schooling, vocational training and trade schools, college and postgraduate study, whether at a public or private institution whether in the United States or abroad, and supplemental education programs and recreational and enrichment activities, whether as part of or in addition to the regular school curriculum. Education also includes all forms of life long learning whether such programs focus on career and business education (including career changes or beneficiaries resuming their education after dropping out of school for a period of time) or the personal curiosity and passions of the beneficiaries. Distributions for education shall include tuition, books, supplies, tutors, travel and related living expenses. I believe that it is important for the Trustee to facilitate educational experiences that will enhance a beneficiary's well being and help him develop a global view and appreciation of diverse cultures. Accordingly, the term "education" also includes reasonable world travel.

When the beneficiary attains age thirty (30), the beneficiary shall become sole Trustee of twenty-five percent (25%) of the beneficiary's trust as then constituted.

When the beneficiary attains age thirty-five (35), the beneficiary shall become sole Trustee of fifty percent (50%) of the remaining balance of the beneficiary's trust as then constituted.

When the beneficiary attains age forty (40), the beneficiary shall become sole Trustee of the remaining balance of the beneficiary's trust.

In exercising their discretion whether to distribute income or principal to or for the benefit of a beneficiary, I wish the Independent Trustees to take into consideration, in addition to such other factors as they deem reasonable, the extent to which the beneficiary demonstrates growth of the following skills, recognized and explained in the written literature about financial literacy:

1. *The ability to live within one's means, i.e., managing spending consistent with one's level of income;*

2. *The ability to manage spending relative to income in a manner that would be consistent with being able to save a portion of income, as needed;*

3. *The ability to understand and manage credit and debt processes, leading to avoidance of excessive debt;*

4. *The ability to maintain reasonable accounting of one's financial resources;*

5. *The ability to understand and manage one's personal assets, either using basic investment procedures and principles oneself or to delegate these actions responsibly to appropriate advisors; and*

6. *The ability to generate income for spending needs if additional resources are required or desired beyond trust distributions.*

In addition, the following two skills are advisable though not crucial:

7. *The ability to use of a portion of one's income and/or financial resources to support charitable activities of one's choosing; and*

8. *The ability to show initiative, engage in entrepreneurship, and demonstrate purpose in paid or unpaid work.*

It is important for the Independent Trustee to recognize that these skills are commonly developed to varying degrees for most people, with few people possessing all of the skills at a proficient level. These are offered here as a useful basis for evaluating a beneficiary's development of maturity, judgment and ability to handle wisely the funds to be distributed by the Trust.

After taking into consideration the extent to which the beneficiary demonstrates the financial literacy skills described above, the Independent Trustees may accelerate by not more than two years the ages at which the beneficiary becomes sole trustee of some or all of the principal of the trust estate if, at such earlier date, the Independent Trustees determine that the beneficiary has the maturity, judgment and ability to handle wisely such earlier distribution and that such earlier distribution is in his best interests. The Independent Trustees may postpone the beneficiary becoming sole trustee of some or all of the principal of the trust estate if, at the time the beneficiary would otherwise become sole trustee, the Independent Trustees determine that the beneficiary does not have the legal competence or the maturity, judgment and ability wisely to administer such principal or becoming sole trustee would not otherwise be in his best interests.

Making mistakes with money is an important tool in learning to manage money. The beneficiary should be allowed to take reasonable risks with money he receives as income or distributions. A goal is for the beneficiary to develop skills in risk assessment, risk capacity, and risk tolerance as well as to learn from both success and failure. The Independent Trustees may best help the beneficiary by acting as experienced mentors offering advice, support, and practical assistance, e.g., developing and managing business plans for new ventures.

The Independent Trustees should allow the beneficiary to encounter the consequences of his decisions. Because the Independent Trustees are instructed to allow flexibility in administration of the beneficiary's trust, they may neither be held liable for poor decisions on the beneficiary's part nor responsible for not having foreseen unanticipated consequences of their decisions.

Disagreements on the part of the beneficiary and the Trustees, including the Independent Trustees, should be seen as normal and an opportunity for learning by the beneficiary. Both the beneficiary and all Trustees should approach conflicts with a desire for collaboration, mutual understanding, negotiation, and demonstration of mutual respect so that conflicts are accepted and resolved using the highest principles of human relationships.

Many conflicts between beneficiaries and trustees arise because the beneficiaries have never read and do not understand the trust, including the rights and responsibilities of both the trustees and the beneficiaries. The Trustees should seek to educate the beneficiaries and the beneficiaries are urged to learn about the terms of the trust and the respective rights and responsibilities of the beneficiaries and the trustees. The Trustees are encouraged to retain consultants to assist the beneficiaries in understanding the trust and in developing the financial literacy skills described above. Such consultants may be retained to work directly with the beneficiaries, to provide advice and counsel for all Trustees, as well as for the Guardians of any minor beneficiaries, or both.

Among the issues that such education should include are the following:

(i) Understanding the mission statement contained in this Section and any related letters from the Settlors and/or videos.

(ii) Understanding the respective rights and responsibilities of income beneficiaries and remainder beneficiaries.

(iii) The Trustees' responsibilities with respect to both distributions and investment of trust assets, including the Trustees' duty to treat both income beneficiaries and remainder beneficiaries impartially, as well as the duty to maintain the purchasing power of the principal while providing a reasonable distribution rate to the income beneficiaries.

(iv) The basics of modern financial theories of investment and the asset allocation of the trust.

(v) The basics of trust accounting, so that the beneficiaries will be able to read and have a reasonable basis to evaluate the accountings prepared by the trustees..

(vi) Basic principles of trustee compensation, as well as compensation to all other regular advisors and consultants.

(vii) The importance of participating in educational sessions and becoming financially literate.

When providing educational programs for the beneficiaries, the Trustees are to keep in mind the people learn in different ways and at different speeds. Various assessment programs exist which will help the Trustees identify how my descendants *learn and to make certain that information is provided to them in a manner tailored to their individual learning styles. Such assessment tools include those which help to identify how we receive, process, assimilate, store and use information, and career or vocational testing which held to identify the beneficiaries' unique individual talents and interests. The costs of all such assessment tools shall be charged against the trust estate and prorated ratably against the various trusts created hereunder.*