[TRUST NAME]

POLICIES AND PROCEDURES

[YEAR]

[Trustee Name], the successor trustee of the [Trust Name], has adopted the following policies and procedures which are informed by the trustee's duties of loyalty and care which are codified in the California Probate Code. The trustee has established a Compliance Calendar so that each year these policies are diligently followed. The trustee has also developed a Compliance Library into which the work product and records of each policy's fulfillment is archived for future reference by this trustee, a successor trustee or the trust's beneficiary(ies).

1. Annual Account: The Probate Code requires that the trustee provide the trust beneficiary an annual account which will include (a) the statement of the receipts and disbursements of principal and income during the last year and (b) the statement of the assets and liabilities of the trust at the end of the reporting period.[1] In response to this duty, a policy has been adopted that each year a report will be provided to the beneficiary(ies) to keep them informed of the activities within the trust during the prior year. This report will include the disclosures and notices required by the statute.[2]

2. Investment Expectations: The Probate Code requires that the trustee's investment and management decisions must be evaluated as part of an overall plan with risk expectations and return objectives reasonably suited to the trust.[3] In response to this duty, a policy has been adopted that the following three key performance indicators will be established and reviewed against the annual investment performance of the marketable securities held by the trust. These key performance indicators are the (1) **Target Real Return** (Inflation+X%), (2) **Target Nominal Return**[4] assuming a 3.0% long-term rate of inflation and (3)

[1] CPC §16062 – Duty to account
[2] CPC §16063 – Annual Account format
[3] CPC §16047(b) – Duty to balance risk and return
[4] Assumed 8% equity return and 3% fixed income return after all investment related expenses.

Expected Long-Term Standard Deviation[5] for the marketable securities held by the trust.

3. Trust Pro Forma: The Probate Code requires that the trustee shall invest and manage the trust assets as a prudent investor would by considering the purposes, terms distribution requirements and other circumstances of the trust.[6] In response to this duty, a policy has been adopted that a “Trust Pro Forma” will be developed and maintained. This pro forma will include the trustee’s expectations of (1) annual gross income produced by the trust, (2) distributions to the beneficiary(ies), (3) disbursements for taxes and other administrative expenses – including the trustee’s compensation and (4) projected long-term appreciation of the trust’s assets. This trust pro forma will be designed to fulfil the trust purposes.

4. Prevailing Factors: The Probate Code requires that the trustee consider the following factors as they administer the trust: (a) the general economic conditions, (b) the possible effect of inflation or deflation, (c) the expected tax consequences of investment decisions or strategies, (d) the role that each investment or course of action plays within the overall trust, (e) the expected total return from income and the appreciation of capital, (f) other resources of the beneficiary(ies), and (g) the need for liquidity, regularity of income, and preservation or appreciation of capital.[7] In response to this duty, a policy has been adopted that the trustee will carefully consider these factors each year to inform their prudent administration.

5. Trust Stress Test: The Probate Code requires that the trustee administer the trust with the care, skill, and caution that a prudent person would use in the administration.[8] A prudent trustee will appreciate that the trust purposes must still be met even during periods when the trust assets do not achieve the return objectives. In response to this duty, a policy has been adopted to “stress test” the trust portfolio by answering the following questions each year:

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[5] Assumed 18% standard deviation on equities and 3% standard deviation on fixed income.
[6] CPC §16047(a) - Duty to prudently administer
[7] CPC §16047(c) - Duty to consider prevailing factors
[8] CPC §16040(a) - Duty to prudently administer

a. Is the gross income of the trust sufficient to address the reasonably anticipated distributions to the beneficiary(ies) and disbursements for the administration this year?

b. If there is an income shortfall (distributions & disbursements exceeding gross income), how many years of this shortfall can be reasonably provided by principal distributions from cash and short-term investment-grade bonds held by the trust? (E.g. $2.0m of cash and short-term bonds / $300,000 income shortfall = 6.6-year shortfall coverage ratio.)

c. Are there any other assets, besides cash and short-term investment-grade bonds, that are expected to provide a ready source of funds to meet any "income shortfall" during periods of heightened market volatility?

6. Diversification: The Probate Code requires that the trustee diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.[9] In response to this duty, a policy has been adopted that no individual security, industry sector or asset class will represent an unreasonably large portion of the portfolio. A report will be created that identifies the five largest (a) non-pooled holdings, (b) industry sectors and (c) asset classes held in the portfolio (both by $ and %). If there are any assets that represent a high concentration within the trust, an evaluation will be made whether, under the circumstances, the concentration is prudent to accept.

7. Illiquid Investments: The Probate Code requires that the trustee make a reasonable effort to ascertain facts relevant to the investment and management of trust assets.[10] In response to this duty, if/when an illiquid investment is approved by the trustee, several key documents will be collected and maintained in the compliance library.

   a. *Illiquid Asset Memo*: An "*Illiquid Asset Memo* will be created that summarizes the key features of the investment such as time horizon, expected rate of return, expected risks, investment type, methodology for valuation, contact information for the general partner, etc.

[9] CPC §16048 - Duty to diversify
[10] CPC §16047(d) - Duty to investigate

   b. *Key Documents*: The trustee will collect and maintain key documents and data in the compliance library which will include the Offering Memorandum (Pitch Deck), Subscription Agreement, Operating Agreement, updated K-1 when available, key communications from the General Partner, etc.

8. Investment Fees: The Probate Code requires that a trustee may only incur costs that are appropriate and reasonable in relation to the assets, overall investment strategy, purposes, and other circumstances of the trust.[11] In response to this duty, a policy has been adopted that a fee study shall be conducted to compare the investment advisor's fee to competitive investment offerings for portfolios of comparable size, complexity, and product mix. Additionally, this report shall include the weighted cost of the underlying pooled investment products or sub-advisors as compared to the average expense ratio of the open-end mutual fund and ETF universe for the same asset classes.

9. Trustee Compensation: The Probate Code requires that the trustee's compensation be reasonable under the circumstances.[12] In response to this duty, a policy has been adopted that the compensation paid to the trustee will be informed by the factors defined by the California Rules of Court Rule 7.776.

10. Conflicts of Interest: The Probate Code requires that a trustee shall exercise reasonable care, skill, and caution by making an effort to ascertain facts relevant to the investment and management of trust assets.[13] In response to this duty, a policy has been adopted that any conflicts of interest between the investment advisor, investment products and the trust will be investigated, acknowledged and disclosed.

11. Selection of Investment Agent: The Probate Code requires that the trustee exercise prudence when selecting investment agents.[14] In response to this duty, a policy has been adopted that the investment advisor's FINRA report will be reviewed to determine if they remain in good standing with the regulatory bodies that oversee their licensure. If the advisor is an Investment Advisor

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[11] CPC §16050 – Duty in incur reasonable costs
[12] CPC §15681 – Duty re trustee compensation
[13] CPC §16047(d) – Duty to investigate
[14] CPC §16052(a)(1) – Duty re selection of an agent

Representative for a Registered Investment Advisor[15], that firm's ADV will be reviewed for any updates or disclosures.

12. Delegation of Investment Duties: The Probate Code requires that the trustee exercise prudence when establishing the scope and terms of the delegation to investment agents.[16] In response to this duty, a policy has been adopted that a written *Delegation of Investment Duties* will be provided to the investment advisor which will include (a) the targeted rate of return, (b) the expected risk as measured by standard deviation, (c) the projected rate of distributions, (d) any minimum cash/bond reserve, (e) any restrictions related to asset concentration, (f) any restrictions related to maximum allocation to illiquid assets, and (g) the agent's management fee.

13. Monitoring Investment Advisor's Activities: The Probate Code requires that the trustee independently review the investment agent's overall performance and compliance with the terms of the delegation.[17] In response to this duty, a policy has been adopted that several reasonable benchmarks will be established to measure whether the risk and return experienced by the portfolio are within an acceptable range of the expected outcomes. Because no single benchmark is a perfect comparison to the portfolio's risk and return profile, a series of benchmarks will be established.

14. Modification to these Policies and Procedures: The Probate Code notes, "Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight."[18] In response to this guidance, these Policies and Procedures will be reviewed and reaffirmed each year. Changes to this document will be thoughtfully considered and infrequently made, with particular emphasis on policies that are timeless rather than those made in reaction to changing market conditions.

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[15] Investment Advisers Act of 1940
[16] CPC §16052(a)(2) - Duty to prudently delegate
[17] CPC §16052(a)(3) - Duty to monitor agent
[18] CPC §16051 - Duty to contemporaneously evaluate

About Anodos: Anodos helps individual trustees save time, reduce their personal risk, and fulfill their fiduciary duties. We do this by helping trustees develop and maintain a series of governance documents - including trustee compensation studies - which demonstrates they have fulfilled each of their duties of care. We also will act as an expert witness to defend our clients' findings in court. What makes us unique is that trustee governance support is all we do. We do not manage money, sell insurance, or accept referral fees. We don't have a horse in the race.