



compliance by charities with the california professional fiduciaries act

MSK Client Alert

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Charitable organizations operating in California should be aware of a law that was recently enacted in California. The law's scope is broad and could have a significant impact on charities that provide trustee services for various types of trusts, including charitable remainder trusts, charitable lead trusts, and pooled income funds.

A. Background.

In 2007, the California Legislature enacted the Professional Fiduciaries Act (the "Act"), which became effective on January 1, 2009, to create a regulatory regime for individual fiduciaries. The Act imposes licensing, continuing education, and reporting requirements on individuals serving as fiduciaries.

B. Status of the Act.

From the outset, it appeared that the Act would apply only to individuals and not to charitable organizations. Unfortunately, the California Department of Consumer Affairs, charged with enforcing the Act, recently issued regulations that expand the scope of the Act and make it applicable, when a charity has been appointed as trustee, to employees of the charity who perform the functions of a trustee.

Earlier this year, a proposed amendment to the Act was introduced in the Legislature that would have exempted charitable organizations from the Act with respect to trusteeship of charitable remainder trusts, charitable lead trusts, and pooled income funds. Unfortunately, it has recently become clear that the amendment is not likely to pass this year. This means that, at present, the Act applies to California charities that serve as trustees of all types of trusts, including charitable remainder trusts, charitable lead trusts, and pooled income funds.



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C. Summary of the Act's Provisions.

The Act requires each person who is a "professional fiduciary" (as defined by the Act) to obtain (and maintain) a license issued by the newly established Professional Fiduciaries Bureau of the California Department of Consumer Affairs.

1. Professional Fiduciary. For purposes of the Act, a "professional fiduciary" is someone who acts as a conservator or guardian for two or more persons at one time or who acts as a trustee, an agent under a durable power of attorney for healthcare, or an agent under a durable power of attorney for finances for more than three people or for more than three families, or any combination thereof at the same time. If someone is acting as a trustee for certain family members, the family members are not counted in determining if the trustee is required to obtain a license.

As a practical matter, this means that, if a charity is acting as a trustee for four or more charitable remainder trusts, charitable lead trusts, or pooled income funds, the charity's employees who are performing the functions of a trustee on the charity's behalf will each be considered a "professional fiduciary" and will need to obtain a license as provided in the Act.

2. Persons Exempted From the Act. Certain individuals and entities are exempted from having to comply with the Act. Exempt individuals and entities include the following: (i) an individual who serves as a fiduciary for members of his or her own family; (ii) attorneys and CPAs who are licensed to practice in California; (iii) persons who are licensed by the IRS as enrolled agents; (iv) banks and trust companies; and (v) licensed investment advisers.

3. Licensing Requirements. If a charity has been appointed as trustee of four or more CRTs or other trusts, its employees who perform the functions of a trustee, who are considered to be professional fiduciaries under the Act, will be required to obtain (and maintain) a license from the California Department of Consumer Affairs.

To be licensed as a professional fiduciary, one must satisfy several requirements, summarized as follows: (i) submit fingerprint samples to the California Department of Justice; (ii) complete 30 hours of pre licensing education; (iii) pass a pre licensing examination; (iv) complete 15 hours of approved continuing education annually; and (v) possess a bachelor's degree from an accredited college or university or an associate degree from an accredited college or university and have at least three (3) years of experience working in the fiduciary field. There are additional administrative requirements that must be met. These include consenting to a credit check, submitting a formal application (which requires the disclosure of certain personal information) signed under penalty of perjury, agreeing to comply with the "Professional Fiduciaries Code of Ethics," and paying an application filing fee. Additional information concerning the licensing requirements may be found at www.fiduciary.ca.gov.

D. Consequences of Violating the Act.

If a person or entity fails to comply with the Act, the California Department of Consumer Affairs may bring an enforcement action against the offending person or entity. Enforcement actions can result in fines, sanctions, and license suspensions or revocations. For serious violations of the Act, the California Department of Consumer



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Affairs could refer the matter to the California Attorney General or to local district attorneys for criminal prosecution.

E. Suggestions for Compliance.

Complying with the licensing requirements of the Act is likely to be expensive, time-consuming, and burdensome, especially if multiple employees of a charity are considered to be professional fiduciaries under the Act. Here are a few suggestions for how California charities might comply with the Act while minimizing these burdens and associated costs.

Instead of having each employee of a charity trustee who currently acts on behalf of the charity in providing trustee services satisfy the Act's requirements, the charity should consider "consolidating" its trustee activities by designating one or more individuals who will perform key fiduciary functions for all trusts administered by the charity. The number of persons designated will likely depend on the number of trusts the charity is administering, and possibly on the division of fiduciary functions between more than one department at a charity, *e.g.*, the business office (for tax compliance and financial reports to beneficiaries) and the development office (for stewardship and other communications with beneficiaries). It may only be necessary for a charity to designate one or two persons who will be responsible for exercising trustee duties for its trusts. The designated employee (s) would be delegated the authority to exercise key fiduciary functions, which would include making decisions on trust investment strategy (in consultation with the charity's investment advisors), signing all tax returns, and signing correspondence and other communications with trust beneficiaries. The designated person will, of course, be able to obtain assistance from other persons as he or she deems necessary, but he or she would have final authority with respect to all material trust matters.

Specifying a small number of persons who will be acting on the charity's behalf to administer its trusts should allow the charity to reduce the number of persons who will be required to obtain a professional fiduciary license. This should help reduce the compliance burden and related costs.

In choosing the persons who will administer its trusts, to the extent practical, California charities should try to select employees who are California lawyers and/or CPAs. This is because lawyers and CPAs who are licensed to practice in California are exempt from having to comply with the Act.

To implement this compliance plan, we suggest that a charity's board (or an authorized committee of the board) adopt a written policy statement directing the appropriate management personnel at the charity to assign the trustee responsibilities for each trust administered by the charity to a specific person. The policy statement should further provide that the person selected shall have the final authority to make all fiduciary decisions concerning the trust that has been assigned to him or her. Moreover, the policy statement should require that each designated person specifically acknowledge, in writing, his or her fiduciary responsibilities with respect to the trusts he or she has been assigned.

We think that adopting this approach will help reduce the resources that a charity will need to devote to ensure compliance with the Act.