

Best Compliance Practices for Trustees When Administering a Special Needs Trust

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Best Compliance Practices for Trustees When Administering a Special Needs Trust

Individual trustees are not held to the same rigorous standards as a corporate trustee. Often advisors argue this is a good thing and that corporate trustees can be expensive. But, is that truly the case? Even if an individual family trustee decides not to charge a fee, there are often professional investment management fees and there is value in hiring an expert. Regulation also provides protection for the beneficiary. Consider the recent example in Florida of a company that was not regulated and did not have proper safeguards to protect the beneficiary from an alleged theft by an individual. and did not have proper safeguards to protect the beneficiary from an alleged theft by an individual.

This paper will examine the requirements of a corporate trustee from the standards established by the Office of the Comptroller of the Currency (OCC). Title 12, Part 9 of the Code of Federal Regulations (12 C.F.R. pt.9 (2026)) sets the minimum framework for corporate trustees: board oversight, written policies, scheduled account reviews, conflict controls, custody, recordkeeping and an independent fiduciary audit. The Comptroller's Handbook published by the OCC provides how examiners test a company's fiduciary framework. If you are an individual trustee or legal counsel representing an individual trustee, these guidelines should be a part of your procedure or practice. If there is a claim that a fiduciary duty has been breached, having proper documentation that these guidelines have been followed will help to protect the trustee.

Special needs trusts (SNTs) add a second layer of complexity. Social Security and Medicaid rules sit on top of regular fiduciary duties. We know that a single misdirected distribution can cut a beneficiary's benefits.

This paper covers four aspects of a trustee's best practices to manage compliance:

1. The regulatory sources a corporate trustee must base its policies and procedures on and best practices for individual trustees to follow as well.
2. What examiners expect to see documented to show that the trustee has made a prudent decision.
3. The additional controls for SNTs.
4. Building an evidence trail in case decisions are challenged.

Regulatory framework

A national bank's fiduciary program is governed mainly by 12 C.F.R Pt. 9. The sources below make up the baseline for a corporate trustee's policies.

Source	What it governs	Why it matters
12 C.F.R. Pt. 9	Fiduciary activities of national banks	Sets the required policies, reviews, records, custody and audit
Comptroller's Handbook: Asset Management	Risk management across fiduciary business	Examination procedures and internal control questionnaires
Comptroller's Handbook: Personal Fiduciary Activities	Personal trusts, estates, guardianships	How examiners sample and test personal trust accounts, including SNTs
Comptroller's Handbook: Conflicts of Interest	Self-dealing and conflicts in asset management	Standards for disclosure and authorization

Part 9 sets process requirements. The substance of the duties comes mainly from state law and the governing instrument. A sound program shows both: the process was followed, and the decision it produced met the standard of care.

Core compliance policies

These are the policy areas examiners expect to find documented. Each item below names the governing rule and the evidence that proves the control works.

1. Board oversight and governance

12 C.F.R. §9.4, the board manages the bank's fiduciary activities. It may delegate this work to directors, officers, employees or committees.

- Keep a board-approved fiduciary charter that delegates authority to a trust committee in writing.
- Make sure committee minutes show real deliberation: discretionary actions, exceptions, complaints, any audit findings.
- Run periodic risk assessments across all fiduciary business lines, tied to a risk appetite statement.

How this applies to Individual Trustees:

- Hire counsel that specializes in representing SNT trustees.

- Consider establishing an advisory counsel to assist the professional fiduciary.
- For a non-profit, have a strong board that questions and reviews management.

2. Written policies and procedures

12 C.F.R. §9.5 requires written policies on these topics:

- §9.5 (c) Preventing self-dealing and conflicts of interest.
- §9.5 (d) Selecting and retaining legal counsel.
- §9.5 (e) Investing fiduciary funds, including funds awaiting investment or distribution.

How this applies to Individual Trustees:

- Have written policies on self-dealing and conflicts of interest that apply to the individual trustee and anyone that works with them.
- Hire counsel that specialized in representing SNT trustees.
- Have written policies on selections of investment managers, retention of investment managers and uninvested cash.

3. Account acceptance and review

12 C.F.R. §9.6 requires three reviews. The reviews are the core evidence that duties are being met.

- **Pre-acceptance review.** Before accepting an account, decide whether the bank can properly administer it. Record the decision.
- **Initial post-acceptance review.** Promptly after acceptance, review all assets of each discretionary account. Many trust companies conduct the review within 60-90 days of account opening.
- **Annual review.** At least once every 12 months, review whether each discretionary account's investments still fit the account.
- **Administrative reviews.** Run these alongside the investment reviews to confirm distributions, notices and tax filings follow the governing instrument.
- **Tickler system.** Use one to escalate overdue reviews. Late or missing reviews are among the most frequent exam findings.

How this applies to Individual Trustees:

- Establish a practice for documenting pre-acceptance of a new account. This is difficult for a family trustee but for a professional fiduciary that serves regularly in this capacity, having a well-documented practice is prudent in determining if you have the capacity and expertise to take on the new trust.

- Most important is having a post-acceptance review process, recommend 90-120 days after accepting the trust. The checklist should make sure all information regarding the beneficiary and their needs, the investment decisions and asset allocation to meet those needs, tax and legal counsel are in place.
- Establish an annual review process to document if there are any changes to the beneficiary's needs, if the investment plan is still reasonable and performing as planned, and if the asset allocation is appropriate.

4. Audit procedures

12 C.F.R. §9.9 requires audit procedures.

- (a) **Annual audit.** At least once during each calendar year, a national bank shall arrange for a suitable audit (by internal or external auditors) of all significant fiduciary activities.
- (b) **Continuous audit.** In lieu of performing annual audits, a continuous audit system of each significant fiduciary activity commensurate with the nature and risk of that activity.
- (c) **Fiduciary audit committee.** The fiduciary audit committee must consist of a committee of the bank's directors or an audit committee of an affiliate of the bank.

How this applies to Individual Trustees:

- Clearly there is not an audit of the individual trustee, but this exercise can be very beneficial.
- Consider having legal counsel review policies and procedures established by the individual trustee
- Consider having outside legal counsel, an accounting firm or another trusted experienced fiduciary review a selection of files to determine if decisions by the trustee are reasonable and documented.
- For a professional fiduciary that has a larger practice, consider retaining an outside fiduciary audit and provide the results to interested parties.

5. Investment management

- Keep an approved investment list. Record the reasoning for each exception.
- Follow valuation procedures for unique and hard-to-value assets, such as real estate, closely held businesses and mineral interests.

- Do not let cash stay uninvested longer than reasonable (§9.10). Collateralize uninsured self-deposits.

How this applies to Individual Trustees:

- Keep an improved list of investment managers that have been screened.
- Establish a procedure for on-going review (consider annually) to review the relationship with the investment manager.
- Review the asset allocation annually and document if it is still appropriate.
- Have a written procedure to have cash invested.

6. Custody and safekeeping

Under 12 C.F.R. §9.13, fiduciary assets must be held under the joint custody or control of at least two designated officers or employees, separate from the bank's own assets. Reconcile regularly with sub-custodians and depositories.

How this applies to Individual Trustees:

- Dual control is not practical for a family member trustee, but they must keep detailed records of every penny spent.
- For a professional fiduciary practice, try to maintain dual control that not one person in the office can disburse funds without the sign-off of someone else.
- When dealing with personal property of the beneficiary, make sure someone else is involved (paralegal, another fiduciary) so nobody can claim something was missing.

7. Recordkeeping

Under 12 C.F.R. §9.8, keep fiduciary account records for 3 years from the later of the account's termination or the end of any related litigation.

How this applies to Individual Trustees:

- Maintain a copy of all fiduciary decisions for a set period of time after the account is closed.
- Determine with legal and tax counsel what records should be kept and for the required period of time.

- Once that time has passed, make sure all electronic copies are also destroyed and not susceptible to cyber theft.

8. Third-party risk management

Run due diligence on any third parties vendors that will have confidential information: investment advisors, technology vendors, marketing companies, etc. before engaging them, and monitor them afterward. The standard is the June 2023 interagency guidance on third-party relationships (OCC Bulletin 2023-17).

How this applies to Individual Trustees:

- Keeping client information confidential is paramount. You may have a secure system but need to confirm that all of your vendors do as well.
- Establish a procedure for on-going review (consider annually) to review the relationship with these third parties.

9. CyberSecurity

12 C.F.R. pt. 9 does not contain a provision regarding cybersecurity for fiduciary accounts, the OCC has incorporated cybersecurity governance into its supervisory framework. The OCC Cybersecurity Supervision Work Program is available through the Office of the Comptroller website under Bank Information Technology guidance.

Trustees maintain sensitive financial records, medical information, Social Security numbers, tax returns, and transfer instructions. Cybersecurity should be viewed as part of the trustee's overall fiduciary duty to safeguard trust assets and beneficiary confidentiality.

How this applies to Individual Trustees:

- Have a written policy around cybersecurity
- Hire a qualified IT firm to evaluate and implement guidelines
- Utilize encrypted devices and secure cloud storage, implement multifactor authentication on all accounts, maintain strong password controls
- Independently verify all payment instructions, avoid relying solely on email communications for financial transactions

Special Needs Trusts

The OCC has no rules specific to special needs trusts. They are governed as personal trust accounts under 12 C.F.R.pt. 9. What sets them apart is that federal benefits law decides whether the trust does its job. Examiners will ask how the trustee makes sure distributions

preserve the beneficiary's eligibility for Supplemental Security Income (SSI) and Medicaid. The Social Security Administration (SSA) guidelines must be followed.

Trust types

Type	Legal basis	Key conditions	Payback to Medicaid
First-party SNT	42 U.S.C. §1396p(d)(4)(A); POMS SI 01120.203	Beneficiary's own assets; disabled and under 65 when funded; sole benefit; may be set up by the individual, parent, grandparent, guardian or court (individuals since Dec. 13, 2016)	Yes, at death, up to total Medicaid paid
Pooled trust	42 U.S.C. §1396p(d)(4)(C); POMS SI 01120.203	Nonprofit manages pooled sub-accounts; sole benefit; no age limit to set up, though funding after 65 may trigger a transfer penalty in some states	Yes, unless the nonprofit retains the funds as the trust allows
Third-party SNT	State trust law; POMS SI 01120.200	Funded by others; beneficiary has no power to revoke or direct distributions	No

Required controls

1. **Acceptance review.** Consider having legal counsel review the trust document against the Social Security Administration Program Operations Manual System (POMS) and state Medicaid rules before accepting it. Record the trust type, establishment date and the beneficiary's age at funding in the file. Determine if the trustee has the capacity and experience to administer the trust.
2. **Distribution standards.** Write a policy covering:
 - Paying vendors directly instead of giving the beneficiary cash.
 - Treating shelter payments (rent, mortgage, utilities) as in-kind support and maintenance (ISM) that lowers SSI, up to a cap.

- For first-party and pooled trusts, a written sole-benefit finding for each distribution, especially purchases shared with family, such as a vehicle.
 - Maintain a list of approved or prohibited categories.
3. **The 2024 food rule.** Since September 30, 2024, SSA counts only shelter as ISM, not food 89 FR 21199. Update distribution matrices and training that was written under the old rule.
 4. **Benefits tracking.** Record the beneficiary's current SSI, Medicaid, SNAP and housing benefits in the account file, and confirm all benefits at each annual review. Know the reporting deadlines.
 5. **Required reporting.** Comply with any reporting requirements imposed by the SSA, courts or the governing instrument, and maintain records sufficient to respond to eligibility reviews and agency inquiries.
 6. **ABLE account coordination.** Since January 1, 2026, the disability onset age for ABLE eligibility is 46, up from 26 (SECURE 2.0 Act §124) Qualified housing expenses paid from an ABLE account do not result in the ISM reduction.
 7. **Investment policy.** Write an investment policy for each account that establishes an asset allocation which balances a longer term horizon with the cash needed for regular distributions. Avoid illiquid assets and make sure cash is in a cash sweep to a money market at competitive rates.
 8. **Termination and payback.** When a first-party trust's beneficiary dies, notify Medicaid and pay its claim before other expenses beyond what state law allows, which is usually limited taxes and administrative costs. For trusts subject to Medicaid payback, trustees should consult POMS and state law before paying post-death expenses because Medicaid reimbursement often has priority over funeral and other expenses. Make sure the specific state requirements are noted in the file.
 9. **Tax treatment.** First-party SNTs are usually grantor trusts (IRC §§671–679). A third-party SNT may qualify as a Qualified Disability Trust for a higher exemption (IRC §642(b)(2)(C)). Trustees should consult with a CPA and record the treatment chosen and why.
 10. **Fees and expertise.** Fees must be reasonable and disclosed, and some states require court or agency approval. Review fees every year and discuss with legal counsel if necessary, document in the account file.

Building the evidence trail

If the trustee is questioned by the beneficiary about a decision made regarding a distribution or investments, or worse, a claim of breach is filed, it is important to show a paper trail of the details behind difficult decisions. Annual reviews of the file, discretionary distribution decisions, meetings at least annually with the beneficiary and decision makers,

annual budgets, investment reviews, proper Investment Policy Statement (IPS), due diligence on the investment manager are the basic requirements for the file.

Litigation lessons: why SNT trustees are held liable

Courts usually hold special needs trustees liable for one of two opposite failures: spending too little, or spending too much carelessly. Two New York decisions are the standard examples. Each matches a control in this paper.

Leading cases

- Matter of JP Morgan Chase Bank, N.A. (Marie H.) (N.Y. Surr. Ct., N.Y. County, 2012).
 - The co-trustees spent about \$3,525 over five years on the beneficiary of a \$4 million trust, while still collecting fees.
 - They had not visited him or asked about his needs, and he stayed institutionalized even though there were funds to provide different care. The court held that prudent asset management alone is not enough and the trustee must understand the beneficiary's needs.
 - The court ordered amended accountings and the reduction or denial of trustee's fees for the period of time the trustee breached its duty.
 - If the Trustee required an annual meeting (the control) with the beneficiary that was documented in the file, the outcome of this case could have been different.
- Liranzo v. LI Jewish Education/Research (N.Y. Sup. Ct., Kings County, June 25, 2013).
 - BNY Mellon approved every discretionary request from the beneficiary's mother without fully evaluating if the expense was appropriate.
- The court stated: "Here, it is apparent that BNY breached its fiduciary duty by authorizing each and every discretionary disbursement requested by the infant plaintiff's mother..." and that the distributions "ran counter" to the purpose of preserving trust assets for the beneficiary's long-term support"
 - The Trustee was surcharged over \$175,000 for improper distributions.
 - The losses included expenses for home health care without checking whether Medicaid would cover it, and funds distributed for cab fares for the family.
 - Some of the payments cost the beneficiary SSI and Medicaid eligibility.
 - The court noted it was "easier to accede" to requests than to evaluate them, and that the trustee ignored trust language requiring it to consider public benefits first.

- If the Trustee required a fully documented decision on how discretionary distributions were evaluated and how the distribution would affect benefits (the control) then the outcome of this case could have been different.

Potential grounds for liability

Ground for liability	What it looks like	Control that prevents it
Failing to use trust for the beneficiary	No contact, no spending plan, fees paid while the beneficiary goes without (<i>Marie H.</i>)	Care plan for each beneficiary; regular contact recorded at each annual review
Approving requests without review	Every request granted; trust drained without regard to how long it must last (<i>Liranzo</i>)	Written analysis of each request; second-level approval above set limits
Distributions that cost SSI or Medicaid	Cash to the beneficiary, shelter costs paid without weighing the reduction, paying for care Medicaid covers	Distribution matrix; check for public benefits first; benefits information on file
Breaking the sole-benefit rule	First-party trust funds spent mainly on family	Written detail for each distribution and if it was for the sole benefit
Self-dealing and fees	Unreasonable fees, undisclosed proprietary products, commingling	Follow §9.12 and have a written conflict of interest policy; disclose all fees and review fees periodically

Ground for liability	What it looks like	Control that prevents it
Imprudent investment	No diversification; assets that can't be sold when cash is needed	Have an Investment policy for each account; document the cash needs of the beneficiary
Failure to account and report	Missed accountings; changes not reported to SSA, leading to overpayment debts	Make sure accountings follow the state statute; document reports to SSA and Medicaid
Mishandling payback at termination	Funeral costs or other creditors paid ahead of the Medicaid claim	Have a Termination checklist that is followed & documented

The remedies courts use are surcharge (the trustee personally repays losses), reduced or forfeited fees, removal of trustee, and restated accountings. Note: In Florida, an adequately disclosed matter in a trust accounting or other qualifying trust disclosure document may trigger the six-month limitations period under Fla. Stat. §736.1008.

Common examination findings and recommendations

Most fiduciary findings for trust companies trace back to a control that exists on paper but were not documented in the account file. The table below pairs the weaknesses examiners commonly cite with practical fixes. Once again, these are practices an individual trustee or non-profit pooled administrator should follow.

<u>Common finding</u>	<u>Practical fix</u>
Annual or initial account reviews late or missing	Automated tickler and way to track reviews

Common finding

Practical fix

Policies not re-approved or out of date with practice

Annual policy calendar; record each approval in the minutes

Committee minutes that only record approvals

Use minute templates that capture discussion, dissent and follow-up items

Audit findings left open

Issue tracker with owners and due dates, reported to the audit committee

SNT distributions that reduced SSI or broke the sole-benefit rule

Distribution matrix, second-level approval for gray areas, annual benefits check

SNT payback order wrong at termination

Termination checklist built from POMS SI 01120.203

Weak oversight of sub-advisors and sub-custodians

Annual due diligence package and performance review

Conclusion

A corporate trustee satisfies the OCC by tying 12 C.F.R. Pt. 9 requirement to a named control and documentation as to each decision. Special needs trusts need the same structure plus a benefits-aware distribution process, kept current with on-going rule changes. Trustees should retain a qualified attorney to advise them on policies and office procedures to protect the Trustee.

This white paper is for educational purposes and is not legal advice. Requirements vary by state law and trust document terms. Confirm specific practices with qualified counsel.

References the Trustee should know.

Regulations and statutes

1. 12 CFR Pt. 9, Fiduciary Activities of National Banks
2. 42 U.S.C. §1396p(d)(4)(A) and (C)
3. 20 CFR §416.1130 and §416.714
4. Internal Revenue Code §529A (ABLE accounts), §642(b)(2)(C) (Qualified Disability Trusts) and §§671–679 (grantor trusts).
5. SECURE 2.0 Act of 2022, §124 (ABLE Age Adjustment), Consolidated Appropriations Act, 2023.

Agency guidance

6. OCC, Comptroller's Handbook: Asset Management.
7. OCC, Comptroller's Handbook: Personal Fiduciary Activities.
8. OCC, Comptroller's Handbook: Conflicts of Interest.
9. OCC Bulletin 2023-17, Third-Party Relationships: Interagency Guidance on Risk Management (June 2023).
10. SSA POMS SI 01120.203, Exceptions to Counting Trusts Established on or after January 1, 2000.
11. SSA POMS SI 01120.200, Information on Trusts, Including Trusts Established Prior to January 1, 2000.
12. SSA, Omitting Food from In-Kind Support and Maintenance Calculations, 89 FR 21199 (Mar. 27, 2024).

Case law

13. Matter of JP Morgan Chase Bank, N.A. (Marie H.), N.Y. Surr. Ct., N.Y. County (2012).
14. Liranzo v. LI Jewish Education/Research, N.Y. Sup. Ct., Kings County (June 25, 2013).