

Feature

An Introduction to **Probate Bonds**

A Guide for Bond Producers and Other Surety Professionals



BY JEFFREY M. FRANK

PROBATE BONDS ARE used to protect the ward in a probate estate, the creditors of the estate, and the heirs of an estate. In some jurisdictions, they are quite

common — so common that the courts permit bond producers to have desks at the courthouse to ease the process of obtaining these bonds. In other jurisdictions they are almost a foreign concept and are rarely, if ever, ordered as a condition of a fiduciary qualifying and serving in a probate estate.

Probate bonds are often given very little thought until things go terribly

wrong. It is then, in the event that the court requires a bond as a condition for the fiduciary to serve, the true purpose of that bond becomes evident. Bond producers and other surety professionals may not have an in-depth understanding of probate bonds and how they work, unless those producers write a large volume of them. This article is designed to provide a general introduction to and a broad overview of this important commercial surety bond.

What types of probate bonds can a court order?

In order to protect the assets of an estate, courts can order probate bonds in four general situations. In each of these situations, the court appoints a fiduciary, who is a person with special responsibility of managing and protecting someone else's

property, to manage a probate estate or trust.

First, there can be a bond to protect the assets of those under a disability. This type of estate is commonly referred to as a guardianship or conservatorship (depending on the jurisdiction). Here, the bond would protect the assets of a minor, such as life insurance proceeds, an inheritance, or the proceeds from a lawsuit, or the assets of a legally incapacitated adult who, for any variety of reasons, is no longer able to manage his or her own assets.

Second, the court can require the personal representative or executor of a decedent's estate to obtain a bond to protect the decedent's assets in a decedent's estate. The personal representative's duties are to collect the assets, pay the decedent's creditors, and then distribute the remaining assets to the heirs.

WHEN OBTAINING THE APPLICATION FROM THE NOMINATED FIDUCIARY, THE BOND PRODUCER SHOULD BE SURE TO OBTAIN A SIGNATURE ON THE INDEMNITY AGREEMENT.

Third, the probate court can order a trustee of a trust to obtain a bond. This often happens when a party moves to register an otherwise private trust with the court. Trustee bonds are also becoming more common with the use of Special Needs Trusts, which are special trusts that permit individuals to obtain a lump sum of money (often from a law suit settlement or inheritance) without losing the ability to continue receiving government benefits.

Finally, courts can order bonds in connection with the sale of real estate. These bonds specifically protect the proceeds of the sale of a parcel of real estate until those proceeds are used for their intended purpose, such as payment of creditors, distribution to heirs, and support of the ward.

Probate bonds must almost always be approved by the court. It is critical that the court review the bond and power of attorney to ensure that it is appropriate. If any issues arise, the obligee or principal should not hesitate to immediately contact the surety.

Underwriting/issuing probate bonds

When a court orders a fiduciary to obtain a bond, that fiduciary will have to find a bond producer to issue the bond. In some jurisdictions, there are producers available at desks in the courthouse to make the process simple. In other jurisdictions, the fiduciary may turn to his or her personal insurance provider to obtain the bond. Some agencies have an on-line presence and permit applications over the internet.

The bond producer issuing the bond should be sure to use the surety's Bond Application, which should contain an Indemnity Agreement. Once the producer has obtained the required information from the applicant, the application

should be submitted to the surety to ensure that it meets all underwriting requirements. The bond producer should make sure to explain the purpose of the bond to the applicant and should also explain the importance of accounting for all assets of the estate. These explanations at a very early stage in the process can help avoid potential claims down the road. It is critical that fiduciaries understand that they should not engage in cash transactions, that they should write checks for all expenses they pay, and that they should retain all receipts. They should also obtain court approval for any significant or out-of-the-ordinary expenditures.

The producer must also make sure that the fiduciary understands his or her duties, such as filing an Inventory and Annual Accounts with the court. It is important that the fiduciary understands that he or she cannot cancel the bond by failing to pay premiums. The bond can only be cancelled by an order of the court. This means that the surety's exposure, as well as the fiduciary's indemnity obligation, can last the entire time that the fiduciary serves and even beyond that time if the fiduciary's Final Account is not allowed by the court, the fiduciary is not discharged, and the bond is not cancelled.

The bond producer should also evaluate the character and qualifications of the applicant. Producers often develop relationships with attorneys practicing probate law in order to obtain probate bond business from them. While the attorneys may be known to the producers, each of their clients should be independently evaluated.

When obtaining the application from the nominated fiduciary, the bond producer should be sure to obtain a signature on the Indemnity Agreement. It is also critical to understand the applicant's prior experience

handling estates and serving as a fiduciary, the assets of the estate or trust, and whether the fiduciary's attorney will be involved throughout the duration of the administration of the estate. In fact, some sureties require attorney involvement prior to agreeing to issue the bond. The producer should make sure to obtain a basic understanding of the issues within the estate.

Underwriting considerations Application

As previously indicated, it is critical that the bond producer obtain the applicant's signature on the Bond Application containing the Indemnity Agreement. In addition, the application should have information regarding the applicant's employer, income, and net worth. In the event of a loss, this will aid in recovery of not only the loss, but also loss adjustment expenses, such as attorneys' fees and costs as well.

The application and underwriting process for a probate bond is different from the process for a performance and payment bond. For example, there are very few documents involved (unless the penal sum of the probate bond is exceptionally large). The surety generally does not review financial statements or balance sheets. At best, the surety will review documents from the probate court file (such as the Inventory, if one has been filed, or an order appointing the fiduciary) and may run a credit report. Because there are few documents involved, the application and the information the producer receives from the principal are critical.

Control of accounts

The bond producer must also determine if the surety will require controls on the estate assets. The controls vary from surety to surety and state to state. They could include joint control of banking or investment accounts with the surety or its authorized agent, joint control of banking or investment accounts with the fiduciary's attorney, court orders that restrict the assets of the

estate, or restrictions on the Letters of Authority issued by the court. Putting one or more of these restrictions in place will not only help limit access to the funds, but also help fiduciaries avoid the temptation of inappropriately accessing and spending the funds.

Attorney involvement

Many sureties require attorneys to be involved from the beginning of the estate administration through

the end. Once an attorney makes that commitment, he or she should provide the surety with some assurance that funds will be properly used and that the estate will be properly administered. Some sureties require that the attorney sign an agreement indicating that if he or she withdraws as counsel for the fiduciary, then the attorney will put the surety on notice of the withdrawal. Other sureties require the attorney to exercise joint control over the funds with the client.

Size of estate

The underwriting for a small estate is generally much easier and quicker than for a large estate. Each surety defines "small estate" or "large estate" differently. Because the surety's potential liability is greater once an estate meets the surety's definition of a "large" estate, the underwriting process for a large estate should not be automated; an actual review of all information should be undertaken by the surety.

Penal sum of bond and assets of the estate

The penal sum of the bond is generally based on the value of liquid assets of the estate, personal property owned by the estate, and the ward's annual income. During the underwriting process, the bond producer should have a clear understanding of the assets in the estate. To the extent the penal sum of the bond is inconsistent with information provided to the producer, he or she should follow up with the fiduciary or his or her counsel to obtain more information about the assets.

Co-fiduciaries

In some situations, the court will appoint two individuals to serve as co-fiduciaries. If a surety is willing to write a bond for two fiduciaries, the bond producer should obtain a bond application with a signed indemnity agreement from each of those fiduciaries. The producer should ensure that the surety issues a single bond in the penal amount ordered by the court as opposed to two separate bonds (one for each co-fiduciary). The issuance of two separate bonds could lead to double the exposure for the surety.

Underwriting red flags

Each surety has its own list of "red flags" that create unfavorable risks for the surety. This especially holds true in larger estates. Instead of simply declining to write a bond when a red flag is raised, sureties can attempt to underwrite the risk by obtaining more information or putting a system of controls in place.



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While each surety may treat red flags differently, the following is a list of typical red flags:

1. The nominated fiduciary is not represented by an attorney.
2. The applicant is not qualified to serve as bond principal.
3. The surety is being asked to issue a bond in an estate that is in the midst of being administered.
4. There are disputes between family members and heirs (especially those that are being litigated).
5. The fiduciary is running an ongoing business within the estate.
6. There is a substantial lapse of time between the date of death and the appointment of the fiduciary to administer the estate.
7. There is a high penal sum without appropriate controls of estate assets in place. (Each surety has its own threshold for a large bond.)
8. The fiduciary has long-term financial obligations.

Claimants on a bond

After the underwriting process is completed, the surety will issue a bond naming the fiduciary as principal. From this point forward, this article will refer to the fiduciary as the principal.

There are generally five types of potential claimants on probate bonds:

1. First, a successor fiduciary who takes over an estate after the principal has resigned, been suspended, been removed, or has died can bring a claim against the principal and its surety.
2. A devisee/beneficiary/heir can bring a claim, especially in situations where his or her interest in the estate is affected by the acts of the principal.
3. A creditor (to whom the estate is indebted) can bring a claim, especially when estate funds have been used inappropriately by the principal, leaving an estate unable to pay a legitimate creditor.
4. An outside third party can bring a claim against a principal based on the breach of an agreement, contract, or in other situations.

5. Finally, a ward can bring a claim against the principal if he or she reaches the age of majority and learns that the estate has been mishandled or if an adult is restored to competency and learns that the principal breached his or her fiduciary duties.

Types of claims and damages

When a nominated fiduciary eventually qualifies as the estate's fiduciary/surety's principal, he or she will have to file an Inventory with the court. An Inventory is a document that sets forth the items in the estate and the value of those items. Principals must also file an Annual Accounting with the court, which itemizes all income and expenses of the estate, as well as the balance remaining, at the end of each accounting period. Often, the failure to file an Inventory or Accounting or the failure of a court to allow an Accounting can lead to a surcharge against the surety.

A surcharge against a surety is, essentially, a judgment against the

surety based on the inappropriate action of the principal and the principal's obligation to pay the estate or trust. A successor fiduciary or other interested party can file a Petition to Surcharge against the principal and surety (discussed later). This is similar to a surety being required to satisfy a payment bond claim because the principal has a payment obligation that he or she has failed to fulfill and the surety has no applicable surety defenses to assert.

There are a number of other situations that can lead to a surcharge as well. Those situations include, but are not limited to, the following:

1. The principal's failure to properly marshal assets (collect the estate's assets).
2. Inappropriate expenditures by the principal (often not for the benefit of the ward).
3. A decrease in value of assets held by the estate, often securities, when they should have been sold.



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4. Failure to properly run a business owned by the estate.
5. Self-dealing or conflict of interest when the principal acts in his or her own interest instead of the interest of the estate.
6. Attorneys' fees and costs incurred in pursuing a claim against the principal and surety.
7. Reliance on counsel (often when a principal gets bad advice from his or her attorney when administering the estate).
8. Failure to file or pay taxes (resulting in interest and penalties owed by the estate).
9. Theft of assets from the estate.
10. Failure to maintain insurance on assets owned by the estate (resulting in a claim if there is, for example, a fire and an uninsured house owned by the estate burns).
11. Failure to collect rent from tenants living in property owned by the estate.
12. Inappropriate charitable contributions.
13. Inappropriate settlement of a claim (often when the settlement is not approved by the court or not in the best interest of the estate).
14. Excess bond premiums (often when the fiduciary fails to

timely complete the administration of the estate, which keeps it open longer than necessary, causing the estate to incur additional expenses).

A practical guide to handling probate bond claims

In the unfortunate situation when a formal claim is brought against a probate bond, the claims handler or attorney defending the claim will conduct an initial review of all available materials in the file. It is critical that the bond producers and underwriters obtain and provide as much information as possible at the time the bond is issued. Not only will the claim handler review any correspondence or pleadings received to initiate the claim, but the claim handler will want to review the surety's internal records, especially the underwriting file. This file should have detailed information regarding the assets of the estate, as well as detailed information regarding the principal, including an address, phone number, employer, and social security number.

The claims handler will then review the court docket and the probate court file. This will provide a chronology of everything that took place from the time the bond was issued to the present. It is important to

determine if the alleged wrongdoing took place prior to or after the bond was issued because, in some jurisdictions, sureties are not liable for wrongdoings that occurred before the bond was issued.

As a practical matter, the claim handler or attorney will attempt to resolve the matter before a formal Petition to Surcharge is filed. A Petition to Surcharge is like a lawsuit against the principal and surety, seeking to obtain a judgment or order to pay against the surety based on the wrongdoings of the principal.

In some situations, the surety might insist that an Order Resolving the Surcharge is entered once the parties have settled the claim. This is often because the Order will include language that will permit the bond to be canceled and the surety to be released from any further liability once the surcharge is satisfied.

Conclusion

The information in this article should help producers understand the importance of obtaining pertinent information about the principal and assets of the estate prior to issuing probate bonds because that is when the principal is most willing to provide information due to the fact that he or she needs the bond in order to qualify as the estate's fiduciary. Any information relating to the principal is extremely useful in the unfortunate event that a bond claim arises.

If a producer has any questions regarding the issuance of the bond, he or she is encouraged to make contact with the surety's underwriting department to ensure all of the necessary pieces of information are in place prior to issuing the bond. ●

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