Private Wealth

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A Matter Of Trust

Trusts stand a better chance of fulfilling their mission if they're put in the hands of a professional.

By Earl E. Watson III

Trusts have been part of the estate-planning vernacular for more than 1,000 years, but the demands being placed on the trustees who administer them may be greater than ever.

That means it is critically important that advisors and their clients only appoint a trustee after careful consideration. It also means clients should think twice about asking a trusted family friend or "wise" uncle to fill the role.

The important role a trustee plays in an overall estate plan can't be overstated. Clients, for example, routinely expect trusts to carry on a family-owned business or carry out an estate plan for multiple unborn generations. At a minimum, a failure to understand the salient factors in selecting a trustee can result in missed opportunities. At worst, it can result in a failure to achieve estate-planning objectives, with irrevocable implications to the client's family and others.

There is a tremendous body of work describing the office of the trustee, many of which would be helpful in evaluating potential trustees. For example, Lord Chancellor Hardwicke, writing in the 1747 case of Knight v. Earl of Plymouth, noted the following: "For as a trust is an office necessary in the concerns between man and man, and which, if faithfully discharged, is attended with no small degree of trouble, and anxiety, it is an act of kindness to accept it."

Hardwicke neatly captured the magnitude of the trustee's responsibilities and the dedication and commitment that's needed to serve in that capacity. It would take another essay to address the basic fiduciary duties of a trustee, but suffice it to say that the trustee cannot take his or her responsibilities lightly. Even seemingly simple trusts require a thoughtful and thorough approach.

For example, a routine trust intention is as follows: "Income to my surviving spouse for his/her life and on his/her death, the trust will terminate with distribution of remaining property, and undistributed income, to my issue." In this scenario, the settlor often will select a trustee from a group comprising a respected member of the settlor's extended family: the oldest child, a longtime friend or neighbor, a lifelong business associate, or anyone thought to be trustworthy and who is expected to be there for the family at all times. The settlor expects the beneficiaries will be more comfortable with someone with whom they are familiar. The close personal relationship with the trustee is expected to ensure that fulfilling the family's needs is a top priority.

Experience shows, however, that this scenario leads to unacceptably capricious results. Sometimes it works and sometimes it does not. When it fails, the personal relationships can be destroyed and the settlor's expectations compromised and unfulfilled.

It may seem obvious, but the more capable the trustee, the more likely the settlor's objectives will be achieved. The ideal trustee offers the type of personal bond you have with Uncle Charlie and the stellar professional credentials of an estate-planning attorney employed by an established trust company.

Uncle Charlie certainly has a lot to offer: a strong personal commitment and familiarity with the family throughout the trust period, both of which are essential to a successful trust experience.

Yet the trustee's obligations are not a part-time job that can be performed at the occasional family gathering. The lives of the settlor and family are always in motion, forever changing. Investment markets, tax legislation and tactical planning opportunities are also dynamic. To be successful, the trustee must have a thorough understanding of the settlor and his or her family. The trustee must also be able to properly administer the trust, oversee the filing of trust tax returns, manage the trust property and provide the beneficiaries with periodic reports of trust investments and transactions. Even if Uncle Charlie has your family's interests at heart, he may not be willing or able to make the necessary time commitment. When trustees cannot meet these requirements, they must make alternative arrangements, which may trigger additional costs that ultimately reduce the assets available to the beneficiaries.

A professional trustee is in a better position to serve the varied and dynamic needs of the trust. Anticipating developments and changing circumstances, the professional trustee is prepared to take appropriate steps to honor the settlor's plan and expectations. Professionals involved in the settlor's planning will generally meet the technical standards of a professional trustee and will serve the settlor and family well. In some cases, their relationship with the settlor spans many years, and they are very familiar with the family and the family with them.

When selecting a trustee, it is also important to recognize that attorneys, accountants, certified financial planners and other financial practitioners aren't necessarily the best fit. Much depends on whether the professional specializes in trustee services. Clients also need to think about what will happen if their attorney or accountant, acting as a trustee, decides to retire. It could put the settlor or successors back to square one.

Other factors to consider when choosing a trustee include:

- the type of trust property;
- the number of beneficiaries;
- the special circumstances of the beneficiaries;
- the expected duration of the trust; and
- the complexity of the settlor's overall estate plan.

These complex factors reaffirm the principle that a trustee must have special skills, experience and resources to carry out the obligations of his or her office. Take the case of a trust property of non-marketable securities—say, a family-owned business. At the settlor's death, the trustee may have to assume management of the business while developing permanent alternative arrangements. Competing and opposing views within the family may make this challenge difficult and extend the time needed to devise a solution. The trustee's job will be even more demanding if the company's value and prosperity were largely due to the talents of the decedent. Distributions to family shareholders may be interrupted. Additionally, the trustee will have to deal with contracts for services and goods, debt covenants, union issues, property leases, multiple locations and specialized industries. It's highly unlikely that one person, even a professional trustee, could deal with this type of scenario. It's a job that would be more suited for a trust company, which generally can provide staff with the needed experience.

If a trust property is a publicly traded family business, a trustee needs to know how to deal with large, concentrated holdings of marketable securities—a scenario that has its own set of unique challenges. Specialized investment skills will be required to diversify the trust and maintain property value. Depending on the size of the position, a public offering or private placement may be necessary. Finally, while arrangements to diversify are being put in place, the property must be protected from adverse market conditions, which require different but equally important expertise. Again, the trustee must be able to recognize when special skills are needed and where to find them.

Trusts established for the benefit of large families may also require the special skills of more than one professional. Large numbers of beneficiaries with varying personal circumstances will demand considerable attention from a trustee. To plan distributions, the trustee will have to be knowledgeable of each beneficiary's personal situation. Separate share trusts will require individual investment policies based on the specific needs of those beneficiaries. Beneficiaries with special medical needs, for example, may require a trustee with an expertise in personal casualty awards, Medicaid eligibility or Social Security disability benefits.

Multi-generational planning is another example of how trustee work can be mired in complexity. Already, several states have repealed their "rules against perpetuity" and others will likely follow. When planning for unborn generations, it is extremely important that trust instruments are flexible enough to enable trustees to respond to unforeseen circumstances. Trustee succession thus becomes a very significant matter. More often, these trusts will provide increased trustee discretion over distributions and property management but there will also be equally important provisions allowing beneficiaries to replace trustees who fail to sufficiently attend to their fiduciary responsibilities.

Today's trusts, although increasingly sophisticated and complex, are also accomplishing objectives and avoiding problems that were unimaginable even a decade ago. An understanding of fundamental trust terms, as well as the considerations in selecting a professional trustee, can help settlors ensure that trusts faithfully carry out their intentions. With that understanding, settlors are in a better position to plan for the future.

Earl E. Watson III, a certified public accountant and personal financial specialist, is the CEO and president of North American Management Trust, an independent investment advisor providing wealth management services to individuals, trusts and institutional clients. He can be contacted at ewatson@namcorp.com.