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SO YOU'VE BEEN NAMED AS TRUSTEE: WHAT'S NEXT?

"The highest of distinctions is service to others."

King George VI

By George Chamberlin

In the context of creating and implementing advanced financial strategies, many of our clients will find themselves in the position of creating one or more trusts to effectuate their estate planning, business succession, charitable and other goals. A necessary part of this process is the selection of the current and successor trustees who will administer these trusts during the client's lifetime and thereafter. Although clients may be trustees of some of their trusts, it is not always practical or tax efficient for a client to act as trustee and the client will turn to persons including family members, financial advisors, attorneys and institutional trustees to handle this important task. So what happens when you or a client are named as trustee for another? Today's article will examine some of the common issues and considerations for one named as trustee.

A good starting point for most trustees is to ask why you were selected by the client to perform this essential function. Often the answer will lie in the relationship you have with the client as well as your professional abilities and acumen. The client seeks a person who will consider the client's goals when administering the trust, thus assisting the client in realizing those goals and making the strategy come alive. The client may not fully understand what he or she is asking of you when selecting you to undertake the duties of trustee. Even so, it is essential that you have an understanding of what the position entails before accepting it.

Generally speaking, the job of a trustee is not for the faint of heart or those preoccupied with other business. It can be very time consuming to handle the administrative duties of a trust even if many facets of the trust's operation are delegated to experts - accountants preparing tax returns, advisors directing investments, attorneys interpreting provisions and the like. Further, the administrative duties of the trustee are only a portion of the overall responsibilities of the position and a trustee must be familiar with both the full range of responsibilities and the fact that many of these duties are fiduciary in nature. Prospective trustees will also benefit from understanding where the potential problems in their service may arise.

Overview of Trustee's Fiduciary Duties

The basic duties of the trustee are numerous and it is important that a trustee is aware of and properly performs each of these duties in the context of the trusteeship. The trust itself is the starting point and the trustee's first duty is to administer the trust in keeping with its terms. The trustee may be required to defend claims made against the trust as well as to enforce legal claims by the trust against third parties. In addition, the trustee has a duty of confidentiality regarding the trust and its activities.

Effective communications with the beneficiaries and other interested persons are another duty imposed on a trustee, including the duties of rendering a periodic accounting of the trust's financial activities, giving notices of actions taken by the trustee and providing other pertinent information concerning the trust as necessary. Where there are two or more beneficiaries, the trustee must treat the beneficiaries impartially. The trustee owes the beneficiaries duty of loyalty as well.

The trustee has the duty to invest the property held in the trust though this particular duty may (and probably should) be delegated to a professional investor or investment advisor. Trust property must be kept separate from other property, including that of the trustee, and the trustee must avoid any conflict of interest. The trustee must perform all of these duties while using appropriate skill and care in their performance and this standard of care is high. In fact, although some trustee duties may be delegated, typically a trustee must not delegate duties the trustee is capable of fulfilling and in any event the trustee must retain the overall responsibility for the trust.

Failure to perform these fiduciary duties leaves the trustee open to the possibility of suit and, worse, to the imposition of damages and other penalties for the failure to perform the duties of the position. This brief overview of the duties is intended only to provide basic familiarity with the nature of the requirements and it will behoove a potential trustee to examine each of these duties further to fully understand their scope and import. This may vary from state to state, though the duties are generally similarly construed, and obtaining professional guidance may be very helpful, particularly where the size of the trust is significant or the likelihood of problems with the trust or beneficiaries seems high.

Investment and Administration

One of the basic responsibilities of a trustee is for the investment and management of the assets of the trust. Trustees are typically empowered to buy and sell and lend and borrow and to perform a host of financial transactions. Today, an enormous variety of investments are available for trusts and other investors and this poses a burden on the trustee who is not highly educated in the financial industry or very experienced in handling investments. Certainly, such a trustee should seek the assistance of a professional

to manage the trust's investments and many trusts provide for this eventuality. The Uniform Prudent Investor Act (UPIA)¹, adopted in many states, provides a strong case for delegating this duty for those trustees without investment experience. Other trustees, though somewhat experienced in investing, may wish to delegate this duty in the interests of time and effort. These circumstances support the client grantor's selection of a financial advisor to serve as trustee in some cases.

Whether the trustee is making the investment decisions or has delegated that duty, trends in the law as applied to trusts and the duties of trustees makes it important to be sure that the investments within the trust are diversified. In addition, given the duty of impartiality imposed on the trustee, assets will need to be invested in keeping with the needs of all beneficiaries, even when interests of the beneficiaries are inherently conflicting.

When a trustee is employing the terms of the UPIA in addressing investments by the trust, the result of those investments may favor income beneficiaries over the beneficiaries of the trust principal or vice versa. In order to assist trustees in dealing with such issues, the Uniform Principal and Income Act (UPAIA)² was developed and has been adopted in many states. The UPAIA was designed to work with the UPIA and to provide guidance for trustees in connection with handling distributions. As will become apparent from the discussion of issues involving the beneficiaries, below, appropriate treatment of the distributions will be critical to the success of the trustee.

Another area in the administration of the trust where the trustee may require assistance and should delegate is in preparing tax returns and in the accounting aspects of the trust. The trustee should keep detailed records of the activities of the trust, particularly the investment selection and performance and the cash flows in and out of the trust. These records will not only be a part of the required communications by the trustee to the beneficiaries but may well be a protection for the trustee against beneficiary claims and the taxing authority where the trust activities are clearly documented.

Working with Beneficiaries

One of the primary tasks for the trustee in administering a trust is interaction with the beneficiaries of the trust. The simplest situation is where there is one beneficiary and the rights of that beneficiary are clearly defined in the trust document. However, there may be multiple beneficiaries and their interests are likely to be in direct opposition as where one or more beneficiaries have a current interest and other beneficiaries have a future expectancy such as a remainder interest. The current beneficiaries seek the maximum income and protection for their interest while the remainder beneficiaries typically seek not only to preserve the assets in trust but would like to see them grow. These expectations place a burden on the trustee and the person directing the investments of the trust where the trustee has delegated this duty. There are statutes governing certain

aspects of trust investment and distribution - such as the UPAIA and Prudent Investor Act noted above - yet the “protections” and guidance of the statutes in place may not always be sufficient for the trustee.

One area in which the trustee will find the handling of beneficiaries to be challenging is where the trustee has some discretion in determining the amount and timing of trust distributions. The mere expectancy will result in some beneficiaries exerting a great deal of pressure on the trustee to make distributions when the beneficiaries want or need them. Beneficiaries will prepare elaborate business plans or other supporting material for their requests and the trustee will need to evaluate these requests even if no distribution ultimately is made.

It is important to remember in the context of the decision making process that the trustee was selected to effectuate the wishes of the client who created the trust and may have a difficult time in determining how best to accomplish those goals. It is a classic conflict for the trustee - the more stringent the interpretation of the client's intent and limitation of distributions, the more likely it is the beneficiaries will seek removal and other sanctions against the trustee. On the other hand, acquiescing in each request for distributions may make it impossible for the trust to survive long enough to fulfill the client's original intent. Making excessive current distributions also opens the trustee to claims by remainder beneficiaries who feel defrauded if the benefits of the trust are passed to the holders of the present, income interests instead of being preserved for the later enjoyment of the remainder beneficiaries.

Many of the above problems can be avoided or at least eased where the client makes clear to the beneficiaries from the outset what the client intends the trust to accomplish and why. Trustees who already know the beneficiaries - as a financial advisor may well know the family of the client establishing the trust - will clearly have an advantage in their dealings with the beneficiaries because of this knowledge and relationship. Even absent prior knowledge of the beneficiaries, it may well serve the trustee to take the time to meet the beneficiaries and commence the relationship proactively.

Another aspect of the trustee's interaction with the trust beneficiaries is the requirement of notice. For example, some states require a trustee to notify any potential beneficiary of the existence of a trust, even if there is no substantial likelihood the beneficiary will ever realize any benefits from the trust. In most cases, the trustee will need to be sure that both current and remainder beneficiaries are aware of the existence and general terms of the trust. This is an important protection for the beneficiaries and a check on the power of the trustee. Certainly, some trustees will not appreciate the need to communicate with contingent beneficiaries but the countervailing interest of the beneficiaries and the need for protection of their rights underscores the need to have disclosure. Where things become more difficult is in the case of the beneficiary who is unlikely ever to realize benefits from the trust and who causes difficulty with litigation - at the cost of the trust - in a fruitless attempt to obtain access to the trust assets.

The Trustee

Quite apart from questions about investments and beneficiaries or how the trust is administered are those questions which help define the trustee's role on a more personal level. Is the trustee remunerated? If the answer is yes, how is the trustee's compensation determined and effected? The level of duties performed by a trustee would suggest that the trustee be entitled to some form of compensation, though some trustees serve without compensation. A trustee may be paid under a fee schedule or hourly or perhaps on a flat fee basis and payment may be received annually, monthly or as the trustee's work is performed and billed to the trust.

What if the trustee, after initially accepting the position, becomes unable to continue for health reasons, disability, retirement or wishes to relinquish responsibility for any reason? Does the trust allow for the trustee to step down and, if so, how may the trustee effectuate the change? The trustee needs to understand what is required in order for the fiduciary responsibility of the position to be fulfilled and when that responsibility will end. Will the trustee be involved in the appointment of a successor or does the trust spell out the process for replacing a withdrawing trustee? On the other hand, may the beneficiaries - or the grantor - remove the trustee? May this be done only for cause or for any reason? What is the process and how is it carried out?

Conclusion

When you or a client are named as a trustee, the first step is to understand what you are being asked to do and the next step is to review the trust and the situation, preferably with the client grantor of the trust. Remember, you are NOT required to accept the responsibility of the trusteeship just because it has been offered. As in the case of choosing a particular investment or engaging in a specific business or personal relationship, you have the right - and the obligation to yourself - to evaluate the position before acceptance. Perhaps the most useful approach for the prospective trustee may be to have a meeting with the client grantor, the beneficiaries, the attorney drafting the trust and any other trustees. Such a meeting will allow for discussion of the issues, assessment of personalities and ascertainment of intent, thus providing a real foundation for the decision whether to accept the trustee position.

When you are evaluating the situation and deciding whether to accept the trustee position, remember that a trustee's job is not a simple one and may consume a great deal of time and energy. Further, between ensuring compliance with legal requirements and the facing the potential for lawsuits and liability, the position is not for every one. This is not to say that the work of a trustee is to be avoided or is going to be caught up in difficulties. Many professionals, including many financial advisors, enjoy the duties and position of trustee. Your enjoyment will be more likely if you are able to make an informed decision whether to accept a trusteeship.

Understanding the role of the trustee and how to decide whether to undertake the role.
This is the future of financial advising.

¹ The Uniform Prudent Investor Act may be accessed at www.law.upenn.edu/bll/ulc/fnact99/1990s/upia94.htm. See also the discussion in “The Advisor as Prudent Investor” September 25, 2002, full text at www.financeware.com/homepage.asp?showsippet=09.25.02.wem

² The Uniform Principal and Income Act may be accessed at www.law.upenn.edu/bll/ulc/upaia/upaia97.htm

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