



Family Wealth Institute

Selecting the right trustee – Some questions to think about

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Trusts are not new. They have been in the laws of the United States since its founding, and actually derived from old English law. Nearly every wealth owner who leaves assets to others, whether through a will or trust, uses some sort of trust vehicle. Sometimes the trust is only there in case the primary beneficiary is deceased or incapacitated, and the gift is to pass to a minor. Sometimes even the primary beneficiary requires a trust, maybe for tax reasons and maybe because of the beneficiary's own limitations. There are countless trust arrangements in effect today, and more on the books to go into effect in the future. For every trust, there is a trustee. This is the individual or institution responsible for managing the assets and complying with the intent of the creator of the trust (known as the "settlor"). Whoever acts as a trustee is considered a "fiduciary", or one who is holding assets for the benefit of another, and who has certain very specific responsibilities and obligations.

The relationship of trustee and beneficiary is similar to an imposed marriage. Both are likely to be somewhat wary of the other. The tensions that exist have frequently led to open hostility and contentious litigation. It's clear that fiduciary litigation is on the rise. The more notorious cases make good press. Liesel Pritzger, granddaughter of the founder of the Hyatt hotel chain, has sued her father for \$1.0 billion, claiming he misappropriated her trust fund to benefit the family's foundation. Bruce Winston sued Deutsche Bank, successor to Bankers Trust, for \$1.3 billion, claiming the trustee failed to properly manage the trust's ownership in the renowned diamond company, Harry Winston, Inc.

Much of this litigation is against the professional trust institutions. Virtually every major bank or trust company has been sued for breach of duty at one time or another. In recent years, there has been considerable increase in the number of private fiduciaries, mostly family members, but increasingly now the estate planning attorney, family accountant, or financial planner, and sometimes independent, non-institutional, fiduciaries. Most of these individuals or "private trustees", however well intended, have little formal training or experience in trust administration. Some have considerable background in financial affairs, but others have none. Conflicts of interest abound, as well as ethical issues.



Anyone can be a trustee. There are rules related to who may conduct a business as a trustee, but this doesn't prevent a settlor from naming himself or anyone else to serve in this function. What should you think about as you select a trustee? How do you identify the right trustee? What is your responsibility to prepare the trustee for this task and what should you expect from your trustee?

The right trustee can protect and grow the assets you have given to the trust, as well as protect and nurture the beneficiary. The wrong trustee can create irreparable economic harm, undermine the potential of the beneficiary, and perhaps destroy a family in the process.

We have developed a series of questions for the estate owner to think about who might best serve in this role and what must the proposed trustee know or understand. This is by no means a complete list of the issues or questions, but it will get you started.

Is it clear why you formed the trust? Will your trustee understand your reasons? How can the trustee manage your trust without knowing what you wanted to achieve? A good trust document will provide a statement of your goals and expectations. Did you intend to

- protect the beneficiary from the reach of future creditors, including the potential claim of an ex-spouse?
- protect the beneficiary from excessive or irresponsible spending?
- create a safety net for the beneficiary and protect him or her from the most severe economic risks?
- incentivize the beneficiary to achieve personal success?
- maximize the beneficiary's cash flow and income, even at the cost of future growth?
- balance the cash flow to the current beneficiary in order to enable the principal to grow for the future?
- enhance the financial skills and experience of the beneficiary in order to prepare him or her for the responsibility of the wealth and to become independent and self sufficient?

What are you looking for in a trustee? Do you want your trustee to have

- experience as a fiduciary? There is obvious advantage to selecting a trustee with experience, but this is not always the same as knowledge or expertise. If you chose an institution as trustee, was it because you had confidence in the depth and range of skills of the institution, or was it because of the individual assigned to your trust? If the individual were to move to another institution, would you want the account moved as well? If the institution were to be acquired by another, would you want to remain as a client?

- investment expertise? This is certainly one of the tasks. But some trustees have little real expertise in the area and can, or perhaps should, hire the “best in class” to provide this function for the trust.
- knowledge of you and the beneficiary? It is important to understand your background and what has motivated you to create the trust, as well as who the beneficiary is. What are the beneficiary’s talents, aspirations, limitations, and fears? How does this individual learn and remember? How well does he or she communicate? Is the trustee capable of dealing with the beneficiary’s anger or frustrations?
- personal skills? Does your trustee have the commitment to this task, communication skills, integrity, and interest in the beneficiary? Do you consider your trustee as an administrator or would you also want the trustee to serve as a mentor?

Most trusts give the trustee discretion on a variety of issues. For example, the trustee may have the power to decide when, why, and how much income to distribute to the beneficiary. What guidelines have you given the trustee? Will the trustee really be able to appreciate what you wanted for the beneficiary, as the circumstances change from time to time? Do you want the trustee to

- support the beneficiary, even if the beneficiary was quite capable of supporting himself through productive work?
- enable the beneficiary to live at the same economic level that you are living at now, even if that means living entirely off of you?
- provide incentives for the beneficiary to become independent and self-sufficient?

If your goals include preparing your beneficiary to become financially competent, productive, and self-sufficient, is your trustee

- willing and able to teach these skills?
- able to draw on trust resources to fund the cost of this training?

The trustee is considered a fiduciary. Is he or she familiar with the rules on fiduciary duties? Would you want your trustee, if not a professional in this field, to be trained properly to carry out these functions? Is it a good idea to rely entirely on lawyers and accountants to tell your trustee what is legal, appropriate, or best practice? Does your trustee understand

- the fiduciary’s duty of loyalty and to whom this duty is owed?
- the investment rules under state law related to trusts?
- the income tax rules that affect trusts, compared to those that apply to individuals?
- the risks involved as a trustee?

One of the biggest risks in appointing a trustee is conflict of interest. If the trustee is more interested in his or her own economic interests, then those of the beneficiary will suffer. Have you required that your trustee



- disclose any economic interest in products or services provided to the trust? Should a bank trustee be expected or permitted to sell bank products to the trust?
- obtain the educated permission of the beneficiary before selling such products or services? Will the beneficiary understand and appreciate the alternatives?
- absolutely refrain from any action that is, or could be considered, a conflict of interest?

Many trusts have more than one trustee. These “co-trustees” have to share responsibilities and authority. If this applies to your trust, do the co-trustees

- have similar experience?
- share the same goals and objectives?
- understand the allocation of responsibilities and authority?
- share compensation?
- share liability?

One of the most common areas of contention is the compensation paid to a trustee. Institutional trustees prefer to charge based on a fixed percentage of the assets under management, for example 1% or 1 1/2% of the market value. For this fee, they typically provide a full range of services, including investment management, administration, and tax compliance. Private trustees often use this same fee standard, but then hire outside investment managers and tax accountants to perform some of the services, at additional costs. Few trusts measure performance on anything other than the size of the portfolio. But consider whether the size of the trust is the full measure of a trustee’s value or success. Sometimes, distributing income or principal to a beneficiary will adversely affect the trustee’s own economic interests. If the trustee is being compensated based on the size of the trust, then the greater the distributions to the beneficiary, the smaller the trust principal. Is your trustee’s compensation based on

- quantitative investment performance? If the trust starts at \$10 million and stays at \$10 million, while the rest of the world has grown at 8% per year, should this level of performance be rewarded or penalized?
- qualitative performance as measured through the relationship with the beneficiary? Is the trustee providing the care, attention, and concern you anticipated?
- experience and expertise as a trustee and fiduciary, rather than in some other profession? Should a lawyer, acting as trustee, be compensated in the same manner as a lawyer, or should he or she be measured as a trustee would be measured?
- amount of time spent trust matters, alone or with others? If there are co-trustees, should the fee to each be reduced and by how much or in what manner?
- difficulty or complexity of the services rendered, including risks and results? In most business arrangements, these features are rewarded.

Selecting the right trustee depends, therefore, on your goals and priorities, the type of trust involved, the needs, interests, talents, and limitations of the beneficiary, the complexity and risk of the work



involved, and your willingness and capacity to appropriately compensate the fiduciary and to give him or her the flexibility to carry out your intent.

Be careful what you wish for. If your stated goal is tax avoidance, you may succeed, but you could risk emotional damage to your beneficiary. If you focus only on the quantitative and investment skills of the trustee, you will likely sacrifice the personal and qualitative skills required. If you don't clarify your intentions and expectations, then even the best trustee will likely fail to perform at the level you would have wanted. Perhaps more than one trustee will be required to meet all the needs, but this requires a careful allocation of duties, responsibilities, as well as fees.

A trust can be an effective tool for protecting assets, creating a safety net for some and a resource that will facilitate the personal success for others. But every trust arrangement, and the choice of any trustee, must be carefully considered. Focus on impact and success, not on tax or fees. Pay attention to the qualitative aspects of this trustee-beneficiary relationship, and listen well to the hopes, aspirations, fears, and doubts of your beneficiary.

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To contact the authors, please call the toll free number at 866-833-1112.

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